The Economist

Civil liberties and terrorism
PAGES 14 AND 29

Progress against al-Qaeda
PAGES 24-25

Bush the divider
EDITORIAL, PAGE 16

Investing in China
PAGE 67

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OPINION
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United States
The Americas
Asia
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Europe
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Cities Guide

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BUSINESS
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Technology Quarterly

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Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

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Mobile Edition
RSS Feeds

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Country Briefings Go
Audio interviews Go
Classifieds Go

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George Bush stands accused of over-reaching himself. America has had little choice … More on this week's lead article

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American foreign policy
Taking on the world

Terrorism and civil liberties
Heading in the wrong direction

Insurance
A heavy hand looming

India
Fazed by the ballot box

British universities
Affirmative action, negative reaction

Letters

On war with Iraq, Japan, Europe and America, Moldova, social capital, management, accounting

Special Report

Al-Qaeda
The other war

Rebuilding Iraq
After the war is over

United States

Civil liberties and terrorism
A question of freedom

Alan Greenspan and the economy
Irking the right

The Estrada fight
A war over two Latino lawyers

Texas taxes
Blowing up the Delaware Sub

Michigan's garbage trouble
Load of rubbish

Lexington
The great uniter?

The Americas

The Andean drug industry
The balloon goes up

Chile
Seeking inspiration

Argentina's economy
Defaulter of last resort

Brazil's new politics
Compromising idealists

Asia

India's economy
A budget for votes, not reform

Pakistan
A timely arrest

South-East Asia's economies
If war comes...

Cambodia and Thailand
The day peace ran out

China
What he did, and left undone

Business

The oil industry
A convenient war, perhaps

Cellular handsets
The local touch

The beauty business
The colour of money

Magazine publishing
What killed the Herring?

Japan's wage round
Heading down

Drug patents
Make love, not war

Bid battles
Sick continents

Face value
Turkey's Berlusconi?

Special Report

Insurance
Poor cover for a rainy day

Finance & Economics

Banking in China
Strings attached

Property prices
Betting the house

Euro-area interest rates
Easier does it

Italian finance
Fiasco

Wall Street
Selling pessimism

Economics focus
The lucky country

Science & Technology

Military technology
Clipping the enemy's wings

Inbreeding
Consanguinity costs

The World Health Organisation
Killjoy woz here

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Cheap chow

Matthew Barney
Sex, life and video games

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Dealing with Iraq
As diplomacy runs out

Religion in Iraq
Iraqis turn to God

Elections in Iran
A weary country

Ramshackle Guinea
Ruler and state in precarious health

An African action movie
Beer makes you sexy

Europe

Turkey
A pivotal nation goes into a spin

A settlement for Cyprus
A last, last chance?

France and Algeria
Partners again

Germany's labour reforms
How far dare the chancellor go?

A new Czech president
Prickly Vaclav Klaus

Poland's minority government
Soldiering on

Charlemagne
Philadelphia or Frankfurt?

Britain

The newspaper industry
Fading

University admissions
Dumb tests

Anti-war students
Dream on

Psychology
Mind how you go

Northern Ireland
Farewell to arms

The tube's Central Line
Mind the gap

Health service reform
Reinventing hospitals

nU fonetics
txt msgN

Bagehot
Bloody, but how bowed?

Peter Smithson
An architect's architect

Obituary

Bernard Loiseau

Economic and Financial Indicators

Overview

Economic forecasts

Output, demand and jobs

Prices and wages

Money and interest rates

Stockmarkets

Trade, exchange rates and budgets

The Economist commodity price index

The world's 12 richest people

Emerging-Market Indicators

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Economy

Financial markets

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Politics this week

Mar 6th 2003
From The Economist print edition

America, Iraq and the UN

Reuters

The foreign ministers of France, Germany and Russia made a joint declaration that they “will not allow” passage of a United Nations resolution authorising **war against Iraq**. America, Britain and Spain continued to push their resolution saying that Saddam Hussein had missed his final chance to disarm. Britain reportedly began drafting a compromise, offering Iraq a “final, final” chance to do so, and a few extra days.

See article: America battles on

Turkey's parliament narrowly defeated a government motion to let 62,000 American troops deploy in Turkey in order to open a second, northern front against Iraq in the event of war. The Americans made plans to airlift the troops into northern Iraq instead. The Turkish government may resubmit the bill.

See article: How the Iraqi crisis still threatens Turkey

The 57 members of the **Organisation of the Islamic Conference** met at an emergency summit in Qatar aimed at averting a war in the Gulf. The delegations of Kuwait and Iraq traded insults.

Pope John Paul II urged world leaders to avoid a conflict in Iraq and sent an envoy to appeal directly to President George Bush.

Spy in the sky

North Korean fighters buzzed an American spy plane over the Sea of Japan about 240km (150 miles) from the North's shores. The United States sent 24 bombers to its Pacific base at Guam.

Khalid Sheikh Mohammed, allegedly the number three man in **al-Qaeda**, was arrested in Pakistan. Officials said materials seized with him suggested that he had recently met Osama bin Laden.

See article: Disrupting al-Qaeda

At least 21 people died when a bomb exploded in Davao airport in the southern **Philippines**. It was the country's worst terrorist attack for more than two years. The army blamed the Moro Islamic Liberation Front, which seeks a separate state in the mainly Roman Catholic country.

A **Sri Lankan** soldier and a policeman captured by Tamil Tiger rebels were released in a move to end a possible hold-up of peace talks designed to end the country's 19-year civil war.

A plan to halve the proportion of hungry people in the world by 2015 may not be met until 2030, according to a UN report on water resources to be presented in the Japanese city of **Kyoto** on March 16th-23rd.

See article: Nor any drop to drink

Sterling's effort

As sterling slid, the IMF urged **Britain's** finance minister, Gordon Brown, to push up taxes or cut spending by $20 billion.

France's finance ministry admitted its 2002 budget deficit had been above the European Union's limit of 3% of GDP, though not far enough to earn a reprimand from Brussels.

Jacques Chirac made the first state visit by a French president to independent (since 1962) **Algeria**, promising a new partnership between the two countries.

See article: France's President Jacques Chirac in Algeria

The **Polish** government led by Leszek Miller and his (ex-communist) Democratic Left lost its junior coalition partner, the Peasants' Party, but is set to soldier on, hoping to win a referendum in June on joining the EU.

See article: Now for the hard part

Estonia's leftish Centre Party, part of an outgoing coalition government, narrowly won a general election, with just over a quarter of the vote. But Res Publica, a new party on the right, got as many seats. The assorted right, with an overall majority, is tipped to form a new government.

A **Greek** court began the trial of 19 members of the far-left November 17 terrorist group for multiple murder. Its members had remained at large for 27 years.

Robert Kocharian, **Armenia's** incumbent president, beat Stepan Demirchian in a run-off election for the job.

A controversial right-winger, Vaclav Klaus, became president of the **Czech Republic**, replacing Vaclav Havel, a playwright and former top dissident who has held the post since communism ended.

EPA

See article: Controversial Vaclav Klaus becomes president of the Czech Republic

Nigeria's deadly hustings

As **Nigeria** braced itself for elections in April, gunmen shot dead an opposition leader, Marshall Harry, and communal fighting claimed more than 100 lives and forced 21,000 people to flee their homes in the eastern state of Adamawa.

Kenya's central-bank governor and tax authority chief resigned amid allegations concerning the collapse of Euro Bank, a weak bank in which state-owned corporations had deposited large sums. Kenya's new government has promised to fight corruption.

A **suicide bomber** in the Israeli city of Haifa destroyed a bus, killing at least 15 people and wounding about 40. It was the first such attack since January, and the first under the new Israeli government. The next day, Israeli troops killed at least 11 Palestinians in a raid in Gaza.

Health of the nation

George Bush retreated from his plan to reform **Medicare**, which covers 40m elderly Americans. He will help the elderly to pay for drugs but will insist that they move to private health plans or pay extra premiums. The proposals would cost $400 billion over ten years.

The Supreme Court upheld California's controversial "**three strikes**" law which sets long prison sentences for anyone convicted of a third felony. A man who stole golf clubs worth $1,200 must complete a 25-year sentence.

Maintaining the drug supply

Mixed news in the **drug war**: in apparent vindication of Plan Colombia, coca cultivation fell in Colombia, but rose in Peru and Bolivia, said the United States. No coincidence, said its critics.

See article: The Andean drug industry

In a test case, **Argentina's** Supreme Court ruled that a decree issued by President Eduardo Duhalde last year converting dollar bank deposits into pesos was illegal. The government, which last year defaulted on some of its debt, is likely to have to issue bonds to compensate depositors.

See article: Argentina's continuing financial tangle

Rio de Janeiro's carnival took place without incident, but under the eye of army troops. They were called out after drug traffickers had struck buses and buildings with incendiary bombs.

A bomb in a shopping mall killed at least seven people in Cucuta, in north-eastern **Colombia**.

Reuters

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Business this week

Mar 6th 2003
From The Economist print edition

Bidding battles

Hugh Osmond, a British deal-maker, launched a £5.6 billion ($9.0 billion) hostile bid for **Six Continents**, after the British-based pub and hotel group rebuffed his advances. Its board claimed that the deal would result only in the "massive enrichment" of Mr Osmond. He countered that the company had drastically underperformed under its present management.

See article: Galvanising shareholders

Pearson's shares rose after the British publishing company (which owns 50% of *The Economist*) reported a 36% rise in pre-tax profits to £399m ($600m) in 2002. The *Financial Times* made only a slender profit for the year, after losing money in the second half; but business improved at Pearson's (much larger) educational-publishing arm and at Penguin, which signed up Madonna to write five children's books.

France Telecom's losses in 2002 weighed in at a massive *euro*20.7 billion ($19.5 billion), up from a loss of *euro*8.3 billion the year before. The heavily indebted telecoms giant made big write-downs of assets acquired at inflated prices in the boom.

Gloom ruled at **GlaxoSmithKline**. An American court said that a cheap generic drug made by Apotex did not infringe the patent on Paxil, GSK's big-selling antidepressant. It makes up some 10% of the British firm's drug sales; GSK said it would appeal.

Fiat lost *euro*4.3 billion ($4.1 billion) last year, much of it in costs of restructuring its ailing car arm. The Italian holding company promised to pump up to *euro*5 billion into Fiat Auto, which launched three new models in the hope of reviving its fortunes.

Media moves

America's **Liberty Media** began a process which would require **Comcast** eitherto buy its 42% stake in **QVC**, a shopping channel, or to sell its own 58% to Liberty. QVC is valued at over $11 billion. If Liberty sells, it could use the cash to bid for Hughes Electronic.

EchoStar reported a loss of $716m in the fourth quarter, largely because the American satellite-TV firm was forced to pay $600m to **General Motors** after its planned takeover of GM's **Hughes Electronics** was blocked by American regulators. EchoStar's boss apologised to shareholders for his losing bet.

Taking scalps

Procter & Gamble was reportedly in discussions to acquire **Wella**, a German hair-care company valued at around *euro*6 billion ($6.5 billion). The American consumer-goods giant hopes to add body and lustre to its range of beauty products.

See article: Unilever and P&G take on L'Oréal

Switzerland's **Nestlé** said that it would continue to pursue a takeover of **Dreyer's**, an American luxury ice-cream maker, even though American regulators have blocked its original plans for a deal over fears for competition at the top end of the market.

America's Supreme Court ruled that **Victoria's Secret**, a purveyor of saucy underwear, had not suffered harm to its trademark from a shop called **Victor's Little Secret**. The small Kentucky outlet also sells intimate apparel as well as other items for a more broadminded adult clientele.

Kosuke Shiramizu, a senior boss at **Toyota**, shared his views of the work ethic of the nationalities employed at the firm. The French work harder than the British (fearing unemployment); loyal Thais are preferable to British job-hoppers; Americans are too well off to work hard; and—horror—the Japanese have adopted European attitudes.

Farewell Frank

Frank Quattrone's once-illustrious career at CSFB ended. The former star technology banker failed to appear before regulators investigating initial public offerings in the boom years. He faces criminal charges over the destruction of documents relating to the probe.

Capital One, one of America's biggest consumer lenders, said that its chief financial officer, David Willey, is being investigated by the Securities and Exchange Commission for possible insider trading.

Profits at **HSBC** rose by 25% in 2002 to $6.2 billion, helped by a fall in provisions against bad loans in Argentina. The bank, one of the world's biggest, said that its priority would be the integration of big acquisitions made last year.

Euro-anaemia

The **euro area's** economic recovery remains slow. GDP grew by 1.3% in the fourth quarter compared with a year earlier, after growing by 0.9% in the previous quarter. The dollar hit a four-year low against the euro.

Concerned about the sluggish euro-area economy, the **European Central Bank** cut interest rates by a quarter-point to 2.5%. The Bank of Canada, in contrast, raised interest rates by a quarter-point to 3.0%.

See article: In the red

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American foreign policy

Taking on the world

Mar 6th 2003
From The Economist print edition

George Bush stands accused of over-reaching himself. America has had little choice

Get article background

THE problems are coming not as single spies, but in battalions. When George Bush decided last year that he was willing to take America to war to defang Saddam Hussein, he cannot have wanted the build-up to end like this, with a divided Security Council, Turkey refusing to let American forces invade Iraq from its territory, and North Korea using America's preoccupation with Iraq to resume its policy of nuclear extortion. This is the background against which Mr Bush proposes not only to invade and occupy an Arab country but also, he said last week, to install a democracy that will serve as “an inspiring example of freedom for other nations in the region”. And all this while America continues to wage a multi-fronted war against the mass murderers of al-Qaeda. You do not have to be in the peace camp to ask whether this president has bitten off more than even a superpower can chew.

Been here before

A good place to begin an answer is with some perspective. However great today's perils, the world is still less dangerous than it was between the second world war and the collapse of the Soviet Union. Invading Iraq may not be the walkover Americans hope for, but will not cost the millions of lives that were lost in Vietnam. The prospect of nuclear-armed rogues, whether dictators or terrorists, is a big worry for the future, but not yet akin to the threat of mutual nuclear destruction the world faced every day during the cold war.

People are apt now to think of the cold war as a stable system of containment, in which the superpowers glowered at one another and yet understood the rules of the game. But anyone old enough to remember Cuba's missiles will know that it was not like that. And though the superpowers never collided in battle, they fought bloody proxy wars in East Asia, the Middle East, Afghanistan, large parts of Africa and many other places besides. In short, people daunted by the threats crowding in on today's America can take some comfort from the fact that these are smaller and less various than they were little more than a decade ago, before America was sole superpower and when the West's values had not yet prevailed almost everywhere over communism and totalitarianism.

Ah, but weren't the burdens of the cold war shared with allies, who are now deserting America in droves? Not quite. It is a pity the big powers have parted company over Iraq. And some of the damage this

parting has caused will take time to mend. France and its supporters in the Security Council believe they are preventing America from using the UN as a flag of convenience under which to pursue its own reckless adventures. The Americans feel they tried to play by the rules, but that the French and others who voted for Resolution 1441 did so in bad faith, never really meaning the “serious consequences” with which that resolution threatened Iraq.

A clash like this on the eve of a possible war is bound to leave a bitter taste. It has already soured relations within NATO and the European Union as well as the UN. But after Iraq, all sides will have an interest in making up. And these fights are hardly unprecedented. During the cold war the Security Council was gridlocked and NATO saw bad fallings-out, such as France's exit from its military structure in 1966 and the uproar over the basing of American missiles in Germany. In those days, moreover, the splits mattered more, because there was a Soviet Union to face down. However excellent it would be for the democracies to save their transatlantic military alliance, it is no longer as essential in a Europe at peace.

But was it necessary to return?

It is, of course, the fact that Europe is at peace that explains much of the present gap in perceptions between Americans and some Europeans. If you think peace broke out when the Soviet Union collapsed at the end of the 1980s, you will not be consoled to hear now that the world has not regressed all the way back to the sort of dangers that existed during the cold war, or that America is facing smaller challenges now than it faced then. Why should the world have regressed at all? And haven't the Americans under Mr Bush picked fights that were not strictly necessary—against Afghanistan, Iraq, North Korea, the Arabs, perhaps even Islam itself?

To these questions the short answer is that peace did not break out with the end of the cold war. Even in Europe, there was bloody tidying up to do (with American help) in the Balkans throughout the 1990s. And while Europe during the 1990s was finishing the job of making itself whole and free, other parts of the world were not so lucky. This was not a decade that established a universal peace, which the Bush administration is now needlessly disturbing. It was a decade during which the Clinton administration neglected too many unresolved problems. During the 1990s Afghanistan under the Taliban turned into the base from which al-Qaeda plotted its attack on the twin towers. North Korea signed an agreement forswearing nuclear weapons, which it went on secretly to break. Saddam Hussein locked out UN arms inspectors and punched gaping holes in the wall of sanctions around Iraq. In Palestine, Mr Clinton did his utmost to bring peace, only to see his efforts consumed by the violence of the *intifada*.

On most of these issues, America now has little choice but to take up the fight. After the felling of the twin towers, it had to strike the country that harboured the destroyers and refused to give them up. And for all the talk that Afghanistan is now worse off than it was under the Taliban, millions of returning refugees think otherwise. In the broader war against terrorism, Mr Bush would be irresponsible if he did not pursue the sort of operations that with Pakistan's help resulted this week in the arrest of al-Qaeda's number three (see article). Nobody apart from America seems able to carry the burden in North Korea: there, the cry from the neighbours is for the Americans—and the Americans alone—to negotiate a new deal with the mendacious Kim Jong Il. In Palestine, the Americans take a lot of criticism, some of it undeserved, for their bias towards Israel. But even the critics acknowledge that in the end it is America that must broker and guarantee a deal. Denouncing American “unilateralism” may be easy on soft issues such as global warming, the International Criminal Court and so forth. On the hard issues, America remains the indispensable superpower, denounced almost as often for withholding its power as for plunging in.

And Iraq? Is this a case in which it was unnecessary for America to plunge into a war, and which might fuel a general Muslim rage against the West? Reasonable people can disagree. Mr Bush (with *The Economist*) has taken the view that an absolute dictator like Saddam Hussein must not acquire the means to destroy hundreds of thousands of lives. But even those who do not accept this case for war should be willing to help Iraq create the post-war democracy that Mr Bush says it is capable of. Russia's foreign minister, Igor Ivanov, said this week that he was concerned about America's plans to “impose democratic values upon entire peoples by force”. Mr Ivanov should consult a dictionary. Democracy is not something that can be imposed. A post-war Iraq may well resist it (see article). But embedding liberal democracy in the Arab world is the best answer the world has to al-Qaeda and its sort, just as it was the best answer to the communists and their sort. Mr Bush should be held to this ambition, not mocked for it.

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Terrorism and civil liberties

Heading in the wrong direction

Mar 6th 2003
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The Bush administration is making a dangerous hash of its terrorism laws

AP

IN 1962 the apartheid regime in South Africa, no respecter of civil liberties, picked up a suspected terrorist leader who had just returned from training in bomb-making and guerrilla warfare in Ethiopia. It marked the start of 27 years in jail, but Nelson Mandela was given access to lawyers and his prosecutors had to follow rules of due process. Last year, the world's foremost democracy, the United States, detained one of its own citizens, Jose Padilla, at Chicago airport as a witness to a grand-jury probe and then categorised the so-called dirty bomber as an "enemy combatant"—which, according to the government, gives it the right to hold him indefinitely, with no access to a lawyer and minimal judicial review.

Though Mr Padilla is unlikely to become a Mandela, his treatment is but one cause for concern about the Bush administration's approach to civil liberties (see article). Of course, September 11th prompted America to reconsider the balance between liberty and security, and to favour the latter; America's freedoms seemed to have helped 19 hijackers to live and train in the country for up to two years. And given the relative lack of a legal structure to deal with terrorism, the American government has often had to think on its feet. Yet even allowing for all this, George Bush is heading in the wrong direction.

The importance of due process

If you accept, as most do, that the war on terrorism justifies wider powers of surveillance and detention, then two principles still need to be applied. First, the government's new powers should, where possible, be enacted in clearly-worded terrorism laws, passed by Congress. Second, wider powers should be balanced by wider review. Spies, now less constrained, should be more answerable for their actions; suspects, deprived of their lawyers for longer periods, should eventually have more opportunity to present their case to a judge and, where possible, a jury; and the whole process should be subject to political and judicial review.

Precisely the opposite has happened. Far from establishing new checks and balances, the government has moved repeatedly to quash those that exist. It whistled one new terrorism law, the USA Patriot Act, through Congress soon after September 11th; now a draconian new "Patriot II" may be pushed through during a war with Iraq. But the government has also claimed new powers by executive fiat, citing precedent from tangentially related cases. Mr Padilla's strange status is justified by an obscure second world war ruling, putting him in a legal limbo similar to that of the "enemy combatants" in Guantanamo Bay. In practice, the government's main legal defence has been delay: it could take ages for the challenges to its behaviour to reach the Supreme Court.

The irony is that, particularly when it comes to surveillance, there is a good case for stronger powers. Despite fiddling with the FBI, America lacks a proper domestic intelligence-gathering service equivalent to Britain's MI5. Similarly, many of the ideas that so exercise American civil libertarians—such as the notion of government agents snooping on places of worship—seem reasonable precautions. But Mr Bush could make his case much more easily if he could also show that the use of these new snooping powers was itself being watched, and questioned, by judges and politicians.

The most disturbing aspect of America's approach comes once terrorist suspects have been arrested. Again, proper terrorism laws should allow a government to treat such people differently from normal criminals, as they are potentially more dangerous than humdrum law-breakers. But the differences should be of degree. By all means hold a terrorist suspect longer before he has access to a lawyer or before specific charges need to be made; but let the lawyer appear in due course. As for claims to be able to hold people indefinitely, powers like these smack of third-world dictatorship.

This week, John Ashcroft, Mr Bush's attorney-general, boasted that the government's tougher methods are yielding results. Recent arrests strengthen his argument. But would his immediate anti-terrorism battles have been so much less effective if he had paid more attention to the basic rules of due process? The public-relations cost has been frightful—particularly among groups such as immigrants and Muslims, whose help is most needed in battling terrorism.

Achieving a balance between security and liberty was never going to be easy. “For a vast and free nation, there is no such thing as perfect security,” Mr Bush reflected last week. But America has jumped too far in one direction. A reassessment is called for, if it wants to avoid rude comparisons with South Africa four decades since.

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Insurance

A heavy hand looming

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Europe's troubled insurers need more sensible regulation

MIGHT Europe's insurers go the way of Japan's? Japanese insurance companies have been in near-perpetual crisis, with many bankruptcies, for over a decade. Their main error was to promise too much to life-insurance policyholders. The state of European insurers is eerily similar to the Japanese in the early 1990s. Indeed, those who wonder if any big bank might go bust in today's lacklustre global economy are looking in the wrong place: it is more likely to be an insurer that goes under. Life insurers in particular, notably in Germany, Britain and Switzerland, are at risk, because their investments have been badly hit by falling stockmarkets. Regulators have offered some relief by relaxing rules on pay-outs and solvency—but not enough to avert the danger of following Japan.

Don't blame the sheriff

European insurers argue that one cause of their problems is the messy patchwork of European regulation and inappropriate domestic supervision. Despite a series of directives to harmonise the rules, they still diverge considerably. Brussels determines minimum requirements for the solvency of both life and non-life insurers, but each country adds its own rules on top. Britain's regulator has a resilience measure that stress-tests investment portfolios for falls in equity markets. The French have their own Gallic version of such a test.

Yet it is too easy to blame regulators for insurers' problems. European insurers are themselves at fault for their biggest failings: mispricing of underwriting risks and the poor performance of their investments (see article). The purpose of regulation should not be to make insurers choose risks more carefully or invest more prudently. Rather, the case for regulating insurers is to protect policyholders, who are not well placed to judge the security of a life insurer, say, and who may also be obliged by law to buy certain types of cover.

When American insurers got into trouble two decades ago, regulators imposed rules that circumscribed their investment unnecessarily. They discouraged investment in equities, for example, by forcing insurers to put up more capital against their risks. As a result insurers park most assets in “safe” investments, largely bonds. That has helped recently; but in the longer run safety implies lower returns, so policyholders end up paying more for their insurance.

The Europeans, who are reconsidering their own regulations, should avoid copying America by interfering

too much in the day-to-day decisions of insurance companies. They certainly need to rethink rules on solvency, possibly adding a component that better reflects long-term investment risk. But their most important role should be to create a safety-net for insurers that get into trouble. Regulators should be ready to intervene sooner in the management of a troubled company to restore its finances. And *in extremis* a “policyholder guarantee fund” should be able to take control. The German life-insurance industry has such a system; others should copy.

New regulation cannot and should not shield insurers from all troubles. Regulators could not have prevented the collapse of Independent Insurance in Britain, say; nor are they to blame for the tribulations of Gerling, Swiss Life, Zurich Financial Services, Royal & Sun Alliance and Scor. But if chronic sickness can be avoided for the entire industry, some European insurers will thrive, many will merge and a few will die. And all will have learned a useful, albeit painful lesson.

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India

Fazed by the ballot box

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From The Economist print edition

The ruling party is keeping too close an eye on forthcoming elections

INDIA is justly proud to be known as the world's largest democracy. Democracy's critics however—for instance, in even-larger China—can seldom resist dwelling on the system's flaws, in particular a tendency for democracies to duck hard decisions, especially at election time. Totalitarian states like China (see article) are not particularly good at tackling awkward problems either. But it is still disappointing to see that, with an election at most 18 months away, India's ruling party seems to have lapsed into do-nothing mode where the economy is concerned, while at the same time stoking the fires of religious hatred for the worst of political ends.

India's latest budget, presented to parliament on February 28th, did have some virtues (see article). It contained plenty to make the middle classes happy, including cuts in the overly-high levels of duty levied on imported liquor and cars, as well as, more usefully, on information-technology products. These reforms, though, were plainly political, aimed at the prosperous voters of the Bharatiya Janata Party (BJP) and offering little to the lower castes, who tend to vote for the opposition. Other market-oriented reforms, such as a cut in the unreasonably high subsidy on fertiliser, looked more a sop to the government's critics, and many doubt that the unpopular measure will ever obtain parliamentary approval. More important, however, is what the budget does not do.

The first thing that the budget does not do is take a necessary axe to India's jungle of tax breaks, dodges, exemptions and twists. Having gone to the trouble of commissioning a detailed report on how to do this from Vijay Kelkar, one of his senior advisers, the finance minister, Jaswant Singh, praised the result and then ignored it in its entirety. For a man presenting his first budget, it was not an inspiring display of reformist zeal. The second thing it does not do is tackle India's most serious structural problem: its galloping budget deficit, now tipped to run as high as 11% of GDP, one of the highest figures for any major economy in the world. The BJP has balked at tax rises, and has displayed little appetite for spending cuts. (The government, it is true, projects a small decrease in the deficit this year, but even if this happens, it will not be enough.) Interest payments on the government's stock of debt already consume a quarter of the budget, making a reduction imperative, but hard and getting harder. With an economy still growing at over 4%, and record foreign-exchange reserves, this would have been, but for the election, an opportune moment for a spot of serious belt-tightening. Yet there is every prospect that there will be another election-mesmerised budget in a year's time, before voting actually takes place.

But the BJP's tendency towards irresponsibility on the economic front pales into insignificance faced with its readiness to play the Hindu card. This was most on show last December in the state of Gujarat, the scene, nine months earlier, of a dreadful massacre in which 2,000 people died in reprisals after a group of Hindus were allegedly murdered by a Muslim mob on their way home by train. Despite evidence that his administration had done nothing to prevent, and may actually have instigated, some of the violence, Gujarat's chief minister, Narendra Modi, called an early election and won. Far from treating him as an embarrassment, the BJP's leadership tried to capitalise on Mr Modi's standing among the hardline element of its support, fielding him as a campaigner in another state election last week, though mercifully without much success.

The saffron vote is actively being courted again, as the government's petition to allow Hindus to begin construction of a temple at the contentious site of Ayodhya was heard by the Supreme Court this week. Few actions could be better calculated to provoke religious violence. The Hindus whose deaths prompted the Gujarat mayhem were returning from Ayodhya, and the destruction in 1992 of a mosque there led to some of the worst rioting India has seen since Partition. Playing with such an issue is folly of immense magnitude. But then again, it might win a few votes.

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British universities

Affirmative action, negative reaction

Mar 6th 2003
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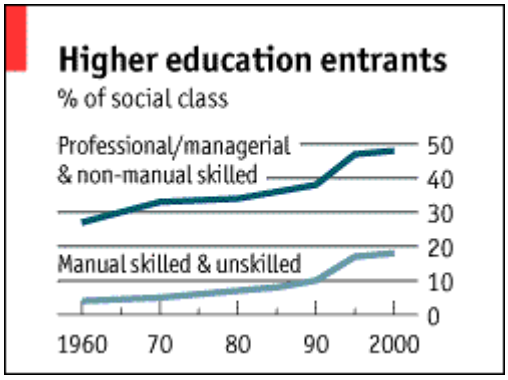
The wrong way to go about getting more poor youngsters into universities



HELL hath no fury like a parent who has struggled to get its child decent schooling only to be faced with a government policy specifically designed to award the child's university place to somebody else. That's why affirmative action led to a decade of rioting in India in the 1980s; why after years of argument California abandoned it in 1996; and why America's Supreme Court may rule it unconstitutional next month. Now the British government is putting its finger into the fire.

What caste is to India and race is to America, class is to Britain. The government is concerned that, while 48% of the children of the top three social classes go to university, only 18% of the offspring of the bottom three do. In order to try to change this, it is giving universities a “postcode premium” on its grants of 5% (rising to 20% next year) for each student from a poor area, and earlier this year it announced plans to set up an “access regulator” to ensure that universities admit plenty of underprivileged children. On March 3rd, Margaret Hodge, the minister for higher education, said that the government was planning to set a national target for the proportion of working-class children which universities should admit. Universities already have individual targets (called “benchmarks”); nevertheless, Ms Hodge was swiftly slapped down by her boss, the education secretary, for this is a sensitive issue. Newspaper columnists mostly fall into the class of cross parents, so nothing, aside from war, is generating so much noise right now.

There are two reasons for trying to get universities to take more poor youngsters, one good, one bad. The bad reason—which Ms Hodge's enthusiasm for quotas gestures towards—is to find a quick fix for deeper social problems. Discriminating against clever, rich students to give thicker, poorer ones a leg-up is unfair and likely to damage higher education without improving society.

The good reason is to try to get more bright people to university. It seems quite likely that some clever, poor children are not getting as good a higher education as they should. Bristol, the university at the centre of the storm, says that, in their final exam, state-school pupils tend to outperform private-school pupils with equivalent A levels, which suggests that thicker private-school pupils are getting through the admissions system. It would not be surprising. A levels were never a brilliant method for screening people, and grade inflation has made them worse, because too many pupils now get excellent results. This year Bristol got 500 applications from pupils with straight As for the 47 places in its English department.

Don't shoot the universities

If the government's aim is to find out which children are clever, and which have been crammed, then setting up quotas or discriminating against people on the basis of their postcode is not the way to go about it. A better screening system is needed (see article).

But this is not the real answer to the problem of poor pupils' underperformance. Low working-class participation in higher education is not, primarily, the universities' fault. They have become the scapegoat for state schools' failings. But sorting out schools is not something that can be done quickly. Starting in the anti-elitist 1960s it took two decades to get rid of a selective secondary system which, despite its faults, gave poor, clever children a real chance. It will take longer than that to rebuild one.

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Letters

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War won't work

SIR – Too often it is assumed that waging war on Iraq will be a magic balm that will make everything fair and just for the Iraqi people, and safe for the region ("Why war would be justified", February 22nd). However, without a properly thought-out policy for governing Iraq afterwards, it may just exchange one set of problems for another. If America is serious about obtaining a fair and just government for Iraq it should look for home-grown solutions. If Iraq is a threat to countries in the region then America ought to find solutions that they welcome. If America is truly benevolent and wishes to make the world a safer place, then it should have no problem gathering worldwide support. As it is, America is having to bully and bribe Iraq's neighbours and members of the UN Security Council into co-operation.

The world does not need more unilateral military solutions; it needs intelligent solutions that minimise the use of violence and command respect and support. War should not be waged because simple and quick alternatives are not available. This war has folly written all over it.

Chris Dornan
Cambridge

SIR – Your support for invading Iraq relies heavily on the demonisation of Saddam Hussein. This responds nicely to Anglo-American rhetoric but ignores the harm that other Iraqis will suffer as a result. Removing Saddam from power would be a godsend but war is too blunt an instrument for the task. If unleashed, we can expect the American military to follow the Powell doctrine of employing overwhelmingly destructive force while minimising the risk to American military personnel. This translates into the maximum use of bombs, missiles and other non-discriminating munitions but the likelihood of getting the leader is small. Given that Saddam's only rational strategy will be urban defence, we should expect the war to result in massive overkill and unwarranted damage. Under present circumstances, this is unacceptable.

It is time for a rethink. More than two alternatives—war and the current inspection regime—exist for dealing with this relatively minor but vexing problem. An overwhelming UN military presence in Iraq is one that deserves robust discussion at the Security Council.

Steven Hillyard
Carmel, California

Japan's war record

SIR – You say of Japan that "In the Gulf war, it did nothing" ("We'll help, but um...ah...", February 15th). In fact, Japan made various contributions in terms of transportation, medicine, equipment and finance. It also provided economic assistance to countries in the region and co-operated with efforts to alleviate the suffering of refugees and repair environmental damage. Japan's government funded this support through a supplementary budget; the Japanese people paid more tax to enable this contribution.

After the war, the Japan Maritime Self-Defence Force was involved in mine-sweeping operations, dealing with mines where access and disposal was particularly difficult. It is true that our involvement in terms of military operations has to be limited. However, it is fair to say, and important to understand, that Japan has been making the utmost effort, within these limitations, to co-operate in tackling difficult issues in

the international arena.

Katsuhiko Oku
Japanese Embassy
London

America's uncertain role

SIR – The “widening gulf of incomprehension” between the American and European public cannot be understood without reference to the messy process of defining America's role (“How deep is the rift?”, February 15th). As the only remaining superpower, it has lost its measure of how much power it should project in the world and finds it difficult to realise that it does not have nearly as much to prove as its present government seems to believe (the mighty efforts of which distort matters further).

America's own public, insufficiently experienced, is made alarmed; friends abroad may hope patiently for eventual maturation, or, like France, show irritation. And worse, others may reply with retaliatory thrusts of diverse method and potency, including terrorism. It simply does not help matters that America appears in need of someone to fight.

The idea that the regime in Baghdad has common cause with al-Qaeda seems the product of a yearning for a bigger and better-located enemy to fight. Iraq's regime ought to be a matter for the world's still young institutions—at the UN and in the Hague. America does not contribute to their effectiveness if its strident and inexpert voice risks divisiveness and confusion at precisely the wrong time.

Olaf Johan Ogland
Old Lyme, Connecticut

Helping out Moldova

SIR – Moldova certainly faces some severe problems, as you starkly describe (“Outsiders aren't helping”, February 15th). Moldova has seen the sharpest fall in GDP of all the former-Soviet republics, since it was the most subsidised. But we have turned a corner. Our investment rating was recently upgraded and our economy has grown for the past three years.

As for the recent conference in Lucerne, we heard no suggestion, official or unofficial, that the European Union should run parts of Moldova's administration. The most important support the EU could give in this situation is, as you say, to open its doors to Moldovan wine and other agricultural products (and why omit textiles?).

Leonid Zeama
Ministry of Finance
Chisinau, Moldova

Capital gains

SIR – Your discussion of social capital focuses on how it might increase the wealth of an individual and a country but you neglect to mention that social capital is itself a form of wealth (Economics focus, February 22nd). Our social connections can help us in business but feelings of connection, and commensurate feelings of safety, comfort and support, are important components of quality of life. Social capital may or may not predict increases in GDP but it certainly predicts higher scores on subjective happiness and other quality-of-life indicators, such as longevity.

Tom Stafford
Sheffield

Australian rules

SIR – You suggest that bullying management may be causally linked to the freedom of the employee to move on and are sensibly non-committal about just how effective it is (“When to terrorise the talent”, February 22nd). However, you ignore cultural factors. Some years ago, I witnessed a Swiss manager cuff a bellboy at a swank new hotel in Australia. The bellboy instinctively decked him and was fired on the spot. The manager lasted only a few uncomfortable months longer. In this country such a reaction is

generic in both office and changing room. It may explain why Australian sportsmen excel on the world stage but our managers do not.

Rob Fraser
Sydney

Ahold's accounting

SIR - You correctly question the statement that European accounting principles are better than Anglo-Saxon rules ("A Dutch crown jewel tarnished", Global Agenda, Economist.com, February 24th). However, you overlook the fact that the biggest anomalies with Ahold actually took place in the United States. Having seen more examples of skeletons in the closet among American daughters of Dutch companies (Numico, Getronics), I get the impression that for the Americans the same has become true as what we always believed about the French: if they sell to a foreigner, something must be wrong.

Niels Van Bladeren
Amsterdam

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Al-Qaeda

The other war

Mar 6th 2003
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AP

The arrest of Khalid Sheikh Mohammed has reminded America of a more elusive enemy than the one in Baghdad

Get article background

THE timing was certainly felicitous. George Bush's critics have been whispering that Iraq is distracting his administration from its “war on terror”. Yet the capture last weekend of Khalid Sheikh Mohammed, a much-sought al-Qaeda suspect, in Rawalpindi, Pakistan, showed that America's intelligence services have not abandoned that other war at all. Far from it; they and Pakistan have netted one of the biggest fish in the al-Qaeda sea.

Mr Mohammed has a résumé that reads like a potted history of anti-American Islamist terror. He has been linked to the World Trade Centre bombing of 1993 that was orchestrated by his relative, Ramzi Yousef. Mr Mohammed and Mr Yousef are thought to have collaborated on the so-called Bojinka plot to bomb several airliners over the Pacific, which was discovered in 1995. He has also been implicated in the bombing of the American embassies in Kenya and Tanzania in 1998; the attack on the *USS Cole* in 2000; and the murder of Daniel Pearl, an American journalist, last year. He has admitted his involvement in the September 11th atrocities, and, according to American officials, had been planning new attacks in America. Mr Mohammed is the most senior al-Qaeda figure caught so far.

His capture could prove useful in several ways. Mr Mohammed himself is now out of commission. His associates may judge that any plans he helped to hatch have been compromised. His personal effects may lead investigators to other al-Qaeda leaders. Pakistan has handed him over to America, but where and by whom he is to be interrogated is unclear: America may choose to entrust the task to friendly regimes with fewer qualms about torture. If Mr Mohammed does talk, he may try to bamboozle his captors with disinformation. But even his lies, when cross-checked with information from other prisoners, could help to sort truth from fiction. Because al-Qaeda plots are known to have long gestation periods, even if he keeps *shtum* for months he could provide vital intelligence. Magnus Ranstorp, of the University of St Andrews, points out that even finding out in general terms about the sort of tactics and targets al-Qaeda is considering will be valuable.

So the jubilation that the arrest induced in the White House may prove justified. Yet, as with the “war on terror” in general, this silver lining has an accompanying cloud. The arrest may speed up rather than

cancel planned attacks. Other al-Qaeda leaders, and an unknown number of foot-soldiers, remain at large. And, since the American-led campaign in Afghanistan, al-Qaeda has become an even more diffuse and amorphous enemy.

The price of victory

Ousting the Taliban and depriving al-Qaeda of its Afghan sanctuary was an important victory for America. It seems likely that al-Qaeda expected, even wanted, an American strike on Afghanistan, and developed what Brian Jenkins, a terrorism analyst at Rand, a think-tank, calls a “business-continuity plan” to safeguard its leadership and finances. But it may not have anticipated the ease and speed with which America prevailed. It will find it difficult to establish another similar base elsewhere, given America's leverage over functioning states and vigilance over failed ones. Al-Qaeda operatives who fled to Pakistan, Iran, Iraq and elsewhere now have to worry about preserving their own lives as well as taking other people's.

Yet for all its successes, the Afghan campaign failed to neutralise some existing risks and may have created new ones. Most obviously, although several al-Qaeda leaders have been killed or captured, Osama bin Laden and his right-hand man, Ayman al-Zawahiri, as well as Mullah Omar, the leader of the Taliban, are unaccounted for. (Mr Mohammed's capture may yet lead to theirs, just as previous arrests are said to have led to his.) Finding or killing Mr bin Laden, who is generally thought to be alive and hiding in either Pakistan or Afghanistan, could risk making him a martyr. But his elusiveness has bolstered his reputation for cocking a mighty snook at America, and helped to make him a powerful totem of Islamist “resistance”.

Success is only partial, too, when it comes to the foot-soldiers. The CIA has estimated that more than 3,000 al-Qaeda operatives or associates have been detained around the world since September 11th, though some have subsequently been released. But because western governments can have only a hazy sense of their adversary's dimensions, as James Woolsey, a former head of the CIA, says, it is hard to tell if that represents “a huge dent, a modest dent, or something in between.” Recruitment seems to have continued since September 11th—though many curious radicals, disenchanted youths or brainwashed jailbirds are needed to make one Mohammed Atta, the lead hijacker. The disruption of al-Qaeda cells in Spain, France, Germany and Britain is both heartening (because it shows that intelligence about them is improving) and alarming (because it shows how well-established the network is in Europe). The FBI suspects there are several hundred Islamists in America with links to al-Qaeda.

The same goes for al-Qaeda's finances. Bank accounts have been frozen and shifty charities scrutinised; this week, America revealed that it was seeking the extradition from Germany of two Yemenis accused of raising money for al-Qaeda, much of it in Brooklyn, New York. But the terrorists can still move cash around via the informal *hawala* system of banking, an old *modus operandi* that helps them to evade detection, as do new ones such as chat-rooms and encrypted e-mails. And al-Qaeda's attacks—even September 11th—have not been all that expensive, especially for a terrorist organisation rich enough in the past to have sponsored states, rather than be sponsored by them.

Increasingly, though, al-Qaeda should probably be regarded less as an organisation than as a movement. (Mr Jenkins's preferred term is “enterprise”.) It has a network of committees at its core, which in the past have co-ordinated major strikes. But thousands of *jihadis* who passed through the Afghan training camps have now dispersed across the globe, forming cells that can act autonomously. Al-Qaeda also has a range of relationships with other terrorist groups, to which, like a venture capitalist, it sometimes offers finance and training. Several of these are in South-East Asia: American troops have been helping the Philippines fight an Islamist terrorist outfit, one of several there, which may have planted the bomb that exploded at an airport on the island of Mindanao on March 4th, killing at least 21 people. Other such groups exist in Kashmir, Algeria, the Horn of Africa and the Caucasus.

One grave future risk is that these affiliated groups will take on al-Qaeda's more grandiose goals. At the moment, they tend to be less well-trained and resourced than al-Qaeda itself, and so are less able to mount catastrophic attacks. So-called “target-hardening” at military and political sites in western countries may have encouraged Mr bin Laden's own people to concentrate on softer economic targets and developing countries since September 11th. The bombing of a synagogue in Tunisia last April, and the killing of a group of French engineers in Karachi last May, seem to fit this pattern.

EPA

Zawahiri and bin Laden, partners in crime

But that is no reason to feel reassured. Daniel Benjamin, of the Centre for Strategic and International Studies in Washington, says that before September 2001 the bombing of the Sari night-club in Bali last October would itself have been considered catastrophic. The FBI estimates that, since September 11th, about 100 terrorist plots have been thwarted around the globe; because security services, for understandable reasons, often intervene earlier rather than later when a plot is detected, it is often hard to know what was being plotted. Long intervals have generally elapsed between al-Qaeda's bigger operations. So it is extremely unlikely that the risk of a symbolic attack with mass American casualties (or perhaps one in Britain, a country that al-Qaeda, despite its threats, has not yet directly targeted) has gone away.

Where and what might it be? In the past, al-Qaeda has been both ingenious in its methods and persistent in its objectives: the ideas of using planes as weapons and destroying the World Trade Centre were nurtured for years. Given its successful use of it by land, sea and air, suicide is one technology it will probably deploy again: FBI agents have been learning about countering such attacks from their Israeli counterparts. Surface-to-air missiles, of the kind used in the failed attempt to shoot down an Israeli airliner last year over Kenya, are plentifully available.

Mr bin Laden is also known to regard the acquisition of weapons of mass destruction as an act of piety, and al-Qaeda could well already have chemical and biological capabilities. Robert Mueller, the FBI'S director, recently conjured up an array of doomsday possibilities in testimony to the Senate, including the poisoning of water supplies. In contrast to almost all other terrorist groups, al-Qaeda seems not to be circumscribed by any self-imposed limits as to how many people it should kill.

The strongest horse

What difference will a war on Iraq make to the “war on terror”? Again, there is good news and bad news. “Iraq will be Exhibit A” in al-Qaeda's recruitment campaign, says Mr Benjamin. Al-Qaeda cells or sympathisers may be activated by a taped message, attributed to Mr bin Laden and broadcast last month, in which he exhorts Muslims to rally to Iraq's defence. (The tape was the latest, albeit inconclusive, piece of evidence that Mr bin Laden is still alive. Some of his previous messages do seem to have provoked attacks.) Intentionally or otherwise, a war may result in some of Saddam Hussein's weapons of mass destruction finding their way into al-Qaeda hands. It might make some useful Arab and Muslim countries less inclined to cooperate in the “war on terror”.

On the other hand, a swift and decisive campaign could undermine Mr bin Laden's belief, derived from America's abortive mission in Somalia in 1993 and its circumspect response to his own early operations, that America, like the Soviet Union, is a weak and flaccid adversary. In one of the videos of Mr bin Laden, broadcast since September 11th, he observes that “When people see a strong horse and a weak horse, by nature, they will like the strong horse.” A triumph in the Gulf could persuade existing and potential al-Qaeda recruits that America is the strongest horse, and that the tide of history is not against this steed after all.

It may also result in a reduced American military presence in Saudi Arabia—a presence that, violating the prophet Mohammed's injunction of only one religion in Arabia, helped to radicalise Mr bin Laden. But there are good reasons to believe that political issues, such as the plight of the Palestinians and American support for the rulers of Saudi Arabia and Egypt, provide convenient propaganda for al-Qaeda and yet do

not represent its ultimate motivation. According to this view, al-Qaeda's aims are as radical and unprecedented as its methods: to unite the Muslim *umma* and destroy western civilisation. If that is the case, Mr bin Laden and his confederates are bound to fail. But they can still do a lot of damage trying.

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Rebuilding Iraq

After the war is over

Mar 6th 2003 | CAIRO
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EPA

Iraq will need coaxing towards democracy. It will be a long haul

Get article background

“THE nation of Iraq, with its proud heritage, abundant resources and skilled and educated people, is fully capable of moving toward democracy and living in freedom.” That was George Bush, in a speech on February 26th. His view of a sweeping and natural transformation, however, is not widely shared. Reconstructing Iraq will be “difficult, confusing and dangerous”, says the Council on Foreign Relations in New York. “It will be a very, very nasty affair,” agrees Joseph Wilson, an American diplomat who once served in Baghdad.

Recent precedents for what America is thinking of doing in Iraq—Panama, Haiti, Afghanistan—are discouraging. Iraq is more complex, and in a more volatile place. Its history, too, gives no comfort. The country was forged by the British, who lost 20,000 troops capturing three neglected Ottoman provinces that were known to be rich in oil. Colonial administrators assumed they could bypass rural chieftains and the urban Sunni elite to impose representative government. A tribal revolt in 1920, suppressed only with mustard gas, convinced them otherwise. The British-backed monarchy, having largely reinstated the old class order, survived until 1958. Three coups later, Saddam Hussein consolidated power with a mixture of oil money, cunning and ruthlessness.

By the late 1970s he had built an impressive state, whose citizens were rewarded for cowed obedience with generous state services. The ideology he espoused was Baathism, a socialist and secular “Arab Renaissance” inspired by European fascism. Baathism professed to subsume Iraq's disparate identities in an overriding Arab nationalism, but in Saddam's practice this often meant playing on tribal, religious and ethnic differences, or brutally crushing minority resistance. Purges at the centre ensured control by a closer, loyalist circle that was mostly Arab and Sunni Muslim. Meanwhile, the state's relentless adulation of Saddam made him a mythical hero even as he led the country to ruin and to war.

Iraq today is a bruised and still divided country. Between Mr Hussein's wars and UN sanctions, it has endured a long process of demodernisation and social fragmentation. Much of the educated elite has fled. Secularism has retreated in reaction to the evident bankruptcy of Baathism, but also in response to the regime's manipulation of religion to sustain its own legitimacy. Incomes have plunged below a tenth of what they were in 1980. Most families rely directly on government food rations to survive, or indirectly

on state salaries. A quarter of children are malnourished. In a place with no trust in civil institutions, but with plenty of cheap firearms, religious, ethnic and clan loyalties predominate. The map below shows an oppressed Shia majority in the south, warily dominant Sunnis in the west, precariously autonomous Kurds in the north, a smattering of Christians, Turkmen and Assyrians, and tribes everywhere.

The present regime has sunk deep, controlling roots. Outside the official armed forces, the layers of coercion consist of some 30,000 members of Mr Hussein's own extended clan, the al-Bu Nasir; another 30,000 from affiliated loyalist clans; an estimated 80,000-200,000 secret police in at least eight overlapping security agencies, and as many as a million party officials, petty informers and profiteers from the president's charmed circle.

That, however, is about the limit of the regime's support in a population of 25m. Most Baathists joined the party solely to protect their families, or for perks such as an automatic 10% upgrade in their children's exam scores. Many of the “loyal” tribes are loyal simply because Mr Hussein gave their leaders guns and Toyota Land Cruisers. “You can never rely on loyalty from tribesmen,” says Khaldoun Naqeeb, a Kuwaiti sociologist who knows Iraq well. “The best you can do is rent it.”

Hearts and minds

How will Iraqis respond to being invaded? Paul Wolfowitz, America's deputy secretary of defence, believes that they will greet Americans as liberators. On the uncertain assumption that victory is swift and civilian casualties are limited, that will doubtless be true of the many Iraqis who have suffered directly at the hands of the regime. The 4m Kurds will certainly cheer, as may the powerful Sunni Arab tribes from the Euphrates valley in western Iraq who have traditionally opposed Mr Hussein's Tigris valley clans. And since Shias make up a disproportionate number of Saddam's victims, more whoops of joy may sound from their strongholds in the south and in Baghdad's squalid east end.

Those who know the country better than Mr Wolfowitz, however, believe ordinary Iraqis will keep their heads down out of simple fear—first of the horror of American weaponry, next of the flailing regime's reprisals against traitors, and finally of vigilante vengeance against anyone associated with the ruling clique. The 3% Christian minority will fear the replacement of Baathist secularism with Islamism. The merchant classes of Baghdad and Mosul will fear vandalism, looting and loss of influence. In short, many Iraqis will reserve judgment on their “liberation” until they see tangible benefits such as security, freedom and food.

If these benefits arrive promptly, most Iraqis will surely be grateful. What they have lacked most, during two decades of war or near-war, is the sense of having a future to plan for and look forward to. Property prices have already risen across Iraq in anticipation of an end to this long state of siege. Yet many still bear deep grudges against America. American bombs, after all, killed thousands of Iraqi soldiers and hundreds of civilians in the last Gulf war; and America is blamed more than Mr Hussein for the subsequent sanctions, which have robbed Iraqis of much of the hope and dignity they used to have.

So how effective will America be at pacifying and reviving a defeated Iraq? Leaving aside the scale of the humanitarian crisis that may face the occupying force, it must first persuade Iraqis of its good intentions. Yet America has not yet finalised its post-war plans. Mr Bush himself has promised that the new nation will be “a dramatic and inspiring example of freedom” to the whole region. Other officials insist that America has a commitment to stay there, but not for too long, ensuring stability at first and the beginnings of economic and political reconstruction. There is talk too, behind the scenes, of a central role for the United Nations in rebuilding Iraq.

But Pentagon planners have also said that an American general would remain in overall charge of Iraq, perhaps for as long as two years. (More like five years and with at least 100,000 troops, say other American military sources.) An American civilian administrator may also be appointed. If so, Iraqis would merely serve as advisers, perhaps in local councils and in specialised committees such as one that will draft a constitution. But America's military men will have to rely on Iraq's existing administrative structures, including Baathist civil servants who, at least at the lower levels, will remain in their jobs. On this calculation, direct rule, with the preservation of service ministries such as health and education, looks the least bad option.

These apparent plans have infuriated the exiled Iraqi opposition, which claims it had been led to believe that it would play a leading role in the transition to a hoped-for democracy, and had hoped to cleanse Iraq of the Baathists as thoroughly as Germany's Nazis were purged. America seemed to view the opposition, with its noisy factions and slim backing inside Iraq, as incapable of running the place. At the end of February, however, an opposition conference set up 14 committees, apparently “ministries in waiting”, in preparation for some role in a provisional government. The Americans also reassured them that they will not stay in Iraq “a minute longer” than they have to. This has pacified the opposition somewhat, though its role is still far from clear.

Circumstances suggest that America's forces will have to build goodwill wherever they can find it: among exiles as well as tribal sheikhs, religious figures, and the competent core of Iraqi technocrats. Just consider the immediate tasks: weeding out and prosecuting hundreds of Baathists implicated in crimes; demobilising much of the 400,000-man army and 80,000-man police force, and then reordering them; declawing intelligence agencies; preventing spontaneous reprisals against the former regime; purging the law of Baathist accretions and rebuilding the corrupted justice system; holding back Kurds from asserting their contentious historical claim to the city of Kirkuk; and curtailing the influence of the armed Shia militias, based in Iran, which have waited 23 years to export its Islamic revolution.

Finding the money

All this will cost money. Will enough be found? America has only recently created a body to co-ordinate ideas for relief and reconstruction. NGOs complain that they have hardly been consulted, and UN agencies, their plans drawn up, remain strapped for funds. There is no hint yet of an international civilian force to do the kind of policing that American troops cannot. And the shallowness of world support for America may mean that too little aid will appear. Friends gave America $54 billion to pay for the last Gulf war. It will be lucky to get a fraction of that this time.

How much money will be needed? The Congressional Budget Office estimates the annual cost of peacekeepers at $250,000 a head. This puts the price for maintaining 100,000 foreign troops in Iraq at $25 billion a year, as much as the country's GDP. Immediate humanitarian aid for 5m people—a low estimate, given the numbers already on food rations—could cost $500 a head, for a total of $2.5 billion. Rebuilding basic infrastructure to the standard Iraq enjoyed in 1990 comes to another $25 billion. Throw in the reconstruction of institutions, from schools and hospitals to universities and museums, and the price-tag grows to $100 billion.

Ah, but Iraq has oil. True, and plenty of it. The trouble is that it is in the ground, and the infrastructure to move it is sadly battered, even if Mr Hussein ignores the option of torching his own wells. Current exports of 2.5m barrels a day (b/d) earn over $15 billion a year. Experts say raising this by 1m b/d will need an

investment of at least $7 billion. Reaching 6m b/d—an ambitious target—would take more than another $20 billion and as much as ten years. At that level, Iraq could begin to pay for its own rapid development. It might even be able to pay some of its existing debt, which is estimated at anything between $60 billion and $140 billion. But with so many claims on oil revenue, relatively little may be reinvested in production.

Since Iraq's reserves are second only to Saudi Arabia's, foreign firms will rush to invest; but only if the place is stable and the terms attractive. The rewards, moreover, will come only in the longer term, meaning a painful stretch when Iraqi expectations and the harsh reality will remain far apart.

Iraq's other great resource is its people. In the 1970s, high levels of schooling, health and regard for women made the country a model of progress. But three-quarters of Iraq's population were born after 1980 and raised in the years of decline and retrenchment. Illiteracy has actually swollen in the past ten years, as top professionals have emigrated, school standards have plummeted and a prosperous middle class has been ruined by sanctions. Corruption has also spread, promoted by Baathist cronyism and the misery of wages that average $10 a month for policemen or schoolteachers.

Iraq is lucky to have a rich pool of émigrés to draw on, but few will risk returning or investing until the country stabilises. Those who do go back will find a society far rougher than the one they left behind. War, poverty and neglect have reduced Basra, beautiful and ancient, to a smelly slum. Baghdad's once-rowdy riverside cafés are derelict. Exiles hoping to recover abandoned property, such as the 100,000 Kurds displaced by Saddam's “Arabisation” schemes around Kirkuk, may be confronted by hostile usurpers. Some ambitious Iraqis, cooped up for too long, may leave as soon as they have the chance. Yet the example of Afghanistan suggests that many of the country's 4m exiles, wealthy and educated as they are, will want to return and help eventually.

Democrats or demagogues?

Which raises another question. Is Iraq capable of becoming a beacon of democracy? Mr Naqeeb, the Kuwaiti sociologist, has some sobering reflections. Democracy requires basic conditions in order to prosper, he says. There must be consensus among the elite about the rules of the game. The public must accept its results. There must be a shared concept of justice and respect for the rule of law. These conditions do not currently exist in Iraq, nor, for that matter, in most neighbouring countries. “Every Iraqi is a potential Saddam,” says one weary exile. “All of them think they speak for all Iraqis.”

Iraq remains a patriarchal society, divided not just by tribe and religion among Kurds, Shias and Sunnis, but also between classes and clans. There are 35 major tribal confederations, some of which span ethnic and sectarian divides. Consider the opposition. Plenty of its parties claim to stand for principles, but the only effective groups remain essentially clan-based. The Supreme Council for the Islamic Revolution in Iraq, a Shia group based in Iran that is the largest and best organised of the Arab parties, has followers in the east of Iraq but few among Shias elsewhere. Many resent its pretensions to speak for them.

Kurdistan, too, remains divided between two clan chieftains who pose as modern politicians. Iraqis jokingly refer to their fiefs as Talabanistan and Barzanistan. As recently as 1996 they fought a civil war; one side sought aid from Mr Hussein, the devil himself. Yet Kurdistan is also palpably freer than it was, with a lively press and a plethora of political parties.

AP

Free, with luck, to speak his mind

Islamism, with its rejection of man-made laws, has made significant inroads into what was once one of the most secularised Arab societies. Its strength, particularly among Sunni Arabs, is unknown, although a clue may lie in the 20% of votes regularly won by Kurdistan's range of mild-to-radical Islamist parties. What is certain is that once Iraq's isolation ends, the xenophobic Islamist rhetoric that dominates the rest of the region will penetrate faster and deeper than the “popaganda” of Radio Sawa, a jaunty, American-funded station beamed at young Arabs.

Iraq's political fragility has its positive side. All current Arab autocracies, like Mr Hussein's, centre on tight networks of one clan, sect or class. But Saddam's levelling sword, and the imminent collapse of his own house, make it unlikely that any single group will soon achieve dominance in Iraq. This opens the way for

a political formula that may break the current, unsuccessful, Arab mould.

Another positive point is that the fear of Iraq splitting into Kurdish, Sunni Arab and Shia states is exaggerated. Since the country is highly urbanised, and has known trauma so recently, its people may be more willing to accommodate diversity than is commonly assumed. The sectarian consciousness of Shias, for example, is not very strong, despite their historical disenfranchisement and the knowledge that they make up 55% of the population. Iraqis note that during the 1991 uprising Shias happily murdered Shia officials, and Sunnis joined the revolt. And although Shias, in contrast to Sunnis, have a highly structured clergy, there is no single Khomeini-like figure to unite them. Indeed, the most venerated Iraqi ayatollahs have historically scorned involvement in politics.

Those tricky Kurds

Iraq's Kurds have the strongest case for independence. Their mountainous region has been in revolt for much of Iraq's history, culminating in Mr Hussein's notorious Anfal campaign of 1988, which scorched Kurdistan and killed at least 60,000 of its people. This was followed by the 1991 refugee crisis that won UN intervention and autonomy. Freedom has brought relative prosperity, a strengthened sense of identity and a steely determination, backed by 80,000 *peshmerga* fighters, to preserve these gains.

The Kurds are aware, however, that they need money and regional support to survive. They have very little oil—unless, as they hope, they can recover Kirkuk, a city ringed with oilfields where Kurds were once in the majority. Moreover, Kurdistan is surrounded by countries—Turkey, Iran, Syria—so worried by their own Kurdish minorities that they would gleefully sabotage any separatist bid. Painful though it is for independence to be so close, yet out of reach, Kurdish realists recognise that they must tread very carefully indeed.

It seems clear that the best political formula for Iraq is a decentralised federation. But where to draw the lines, and how to share the spoils? Some Shia parties, for example, harbour ambitions of creating an Islamist fief in the south, which holds the bulk of Iraq's oil reserves. The Kurds have proposed a constitution that would divide the country into Kurdish and Arab sub-states, with power at the centre apportioned on ethnic lines. Most contentiously, they dream of an internal border that allots big chunks of “Arab” northern Iraq to Kurdistan, including Kirkuk. But extremists among the 500,000 or so Turkmen who live in Iraq are ready to call in Turkey to keep the Kurds out.

Wiser counsel suggests that Iraq should be a federation of strictly administrative regions, not of tribes. It is argued, too, that allowing the central government to suck in all the oil revenue is a recipe for future oppression. But hashing out all these questions will take time and patience in abundance. Those, not oil, will be the most important resources.

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Civil liberties and terrorism

A question of freedom

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The Bush administration is obliged to tighten up security. But is the cost to liberty creeping unnecessarily high?

ON MARCH 1st the new Department of Homeland Security, the product of the biggest reorganisation of the American government in 50 years, started work. But that change looks like mere bureaucratic reshuffling compared with the quieter, but far bolder, overhaul by the Bush administration of the government's powers of investigation, surveillance and arrest.

The starting-point for the administration is simple and understandable. “We are in a war and we have to do things differently than we did before,” John Ashcroft, the attorney-general, has explained. The war, against terrorism, requires not only the creation of new departments and reorganising the FBI, but also changes to most of the rules which govern what these authorities are allowed to do.

Citing the arrests of some al-Qaeda members this week, Mr Ashcroft told the Senate Judiciary Committee that the new approach is doing well. He declared that America is “winning the war on terrorism” and that “our strategies and tactics are working”. Even Mr Ashcroft's critics will hope that this claim does not come back to haunt him. Nevertheless, successful arrests will not dispel alarm about the administration's appetite for new domestic policing powers and its apparent impatience with concerns about civil liberties.

America is not the only democracy to have reduced the legal constraints on its policemen since the terrorist attacks of 2001. But the change in the balance between liberty and security is especially striking in the United States. Americans have enjoyed unusually explicit and deeply rooted protections for individual rights. It was these freedoms that were exploited by the September 11th hijackers.

Two big changes mark the government's anti-terrorism policy. The first is to focus not on catching and punishing terrorists after an attack—the usual goal of law-enforcement—but on preventing one from taking place. The second is to consider terrorism no longer primarily as a threat from abroad. In the past, despite their howls about congressional oversight, American spies abroad have been freer in what they can do than their domestic equivalents. Now the idea is for more of the same powers to be wielded domestically.

Many people would, in principle, accept these two changes. The real complaint of civil libertarians centres

on the way they have been put into practice. Rather than trying to set up a clearly defined new set of rules, enshrined in an emergency law, to deal with terrorism—as exists in most other countries—the Bush administration has tried a more piecemeal approach, with a bunch of legislated changes accompanied by the bald assertion of new powers by the government itself.

The main piece of legislation so far is the USA Patriot Act, pushed through Congress by Mr Ashcroft soon after September 11th. A somewhat blurry creation, it increased the powers of investigators and prosecutors that had been established under the 1996 Anti-Terrorism Act (passed after the Oklahoma City bombing). Now a leaked draft 120-page bill, known as the “Patriot Act II”, seems to indicate that Mr Ashcroft is planning to claim even broader powers of surveillance and arrest, including the right to strip Americans of their citizenship. This week he insisted that no final decisions had been made; but he also refused to rule out further legislation, and many fear that he is planning to introduce a bill in the overheated atmosphere following an invasion of Iraq.

On top of the Patriot Act, Mr Ashcroft and other government officials have simply claimed a wide range of new powers over both immigrants and citizens. When challenged on issues such as its right to call people “enemy combatants” (and imprison them indefinitely), the administration has cited doubtful second-world-war precedents and insisted that it is operating “within the constitution”.

Although one of the principal aims of the American constitution's Bill of Rights was to restrict the government's powers to spy on suspects and lock them up preventively, this legal tactic has drawn few protests. The various cases challenging the government are bogged down in appeal courts; they may take years to reach the Supreme Court. The administration has also chosen to fight many of its battles in immigration courts, where the power of judicial review is more circumscribed. And, as in other countries, judges have been fairly sympathetic to the government at a time of national emergency.

The political impact of all this has been more mixed. At home, concern about civil liberties is rising, and the administration's seizure of more powers has alarmed even some of its own supporters. Abroad, true stories of Uncle Sam locking up foreigners and depriving them of basic rights have helped give credence to rumours of torture and intimidation.

Moving the line

Some themes emerge from the maelstrom of new laws and assertions. One is that, from a civil-liberties viewpoint, the administration's treatment of suspects gets less defensible the further it pursues them. Increased surveillance of suspects often seems justified; most abuses come after they have been arrested. Another theme is a recurrent one: a continual lack of judicial and congressional oversight. Five areas of concern stand out:

• **Extending surveillance.** The Patriot Act has given the government new powers to bug telephones, monitor e-mails and internet use and scour public databases. Many of these changes seem sensible, such as roving wiretaps aimed at suspects rather than individual telephones, and easier information-sharing between law-enforcement and intelligence agencies. Most other democracies with terrorist problems have already done these things.

This does not mean that the act has no troubling aspects. For instance, civil libertarians moan that it allows the government to compel internet-service providers to disclose any record that it believes might help its investigations, even if the information has nothing to do with a suspect.

Interestingly, surveillance is the part of the civil-liberties debate that makes ordinary Americans most uncomfortable. “Operation TIPS”, a Justice Department plan last year to recruit millions of American workers to report “suspicious” activity, provoked such a hostile reaction that the Senate explicitly banned it in the law establishing the new Department of Homeland Security. An Orwellian Pentagon scheme to analyse government and commercial databases for suspicious activity, called “Total Information Awareness”, has also been blocked for the moment. There has been a revolt by librarians, bookshops and universities against demands by FBI and other officials for access to their records.

• **Guilt by association.** The American government wants to target the financial and logistical support for terrorist groups. But this is complicated. Many groups involved in violence, such as Hamas and the IRA, also have wings which do legal things, such as running schools or holding rallies. After the hysteria of the McCarthy era in the 1950s, the Supreme Court and Congress together established a clear dividing line: membership in or association with a group designated by the government as hostile was not illegal.

Some distinct criminal activity had to be proved.

The 1996 Anti-Terrorism Act reversed this, making it a crime to offer such groups any “material” support. The Patriot Act went further. Under its provisions, it would have been a crime to support the African National Congress during Nelson Mandela's imprisonment. Giving money to a Chechen orphanage, or a hospital on the West Bank, could also land someone in trouble if the government puts the group running it on its terrorist list. Patriot Act II would allow the government to maintain a DNA database of anyone suspected of supporting a designated group, even if he is not charged with any crime.

Again, the main problem is not the intent, but the lack of oversight. Civil libertarians point out that the new laws make it difficult for Congress or the courts to monitor or question the designation of terrorist groups by the government.

• **Targeting immigrants.** In the months after the September 11th attacks, some 1,200 immigrants, mostly Muslims, were rounded up by police and immigration officials across the country. Some of these were held for months before seeing a lawyer or being brought before an immigration judge. Most have since been released, some were deported, and only a few were charged with a crime. This practice seems to have continued, though the government has stopped reporting the arrests.

The Department of Justice has also enforced a long-dormant registration requirement on men from 25 countries, all but one of them Arab or Muslim. Of the 32,000 men who have registered so far, 3,000 face deportation—many of them apparently for relatively minor offences. Both the current and proposed Patriot Acts drastically reduce the rights of immigrants, legal as well as illegal. For instance, Patriot I allows the indefinite preventive detention of immigrants on the say-so of the attorney-general, even if they have committed no crime and cannot be legally deported.

• **Redefining due process**. The Bush administration's most extreme act involves “enemy combatants”. Its decision to hold indefinitely 650 prisoners from Afghanistan at Guantanamo Bay in Cuba, neither allowing them prisoner-of-war status nor charging them with a crime, has drawn protests from around the world as a breach of international law. That point is at least debatable. But its treatment of two American citizens held within the United States has been, from a legal point of view, even more drastic and less justified.

Government lawyers have argued that the courts have little or no oversight of the detention of enemy combatants, that these men have no right to see a lawyer or anyone else, and that they can be held until the war on terrorism is over, which may mean for ever. Such isolation, they explain, is necessary to obtain intelligence about further terrorist attacks.

The “enemy-combatant” tag might fit Yaser Esam Hamdi, an American-born Saudi captured in Afghanistan. But Jose Padilla, the so-called dirty bomber, was first detained at Chicago airport as a material witness to a grand-jury probe, not as a criminal suspect or hostile fighter. Only later was he transferred to a navy brig as an enemy combatant, and then solely on the authority of the president. A judge has ruled that he should be able to see a lawyer, but the government has refused this and appealed against the decision.

Put it another way: Mr Bush's people are claiming that the government has the right to imprison anyone, citizen or not, perhaps for ever, inside America without having to charge him or her with a crime or do much to demonstrate to a judge that it has reason for its suspicions. Naturally, it says it will use the enemy-combatant designation only in extreme circumstances. And yet it is hard to think of any time when the American government has claimed so much power over its own citizens without reference to Congress.

Not that what it may be planning to submit to Congress is likely to soothe such concerns. The draft Patriot Act II would give officials the power to strip American citizenship from anyone suspected of giving “material support” to a group designated by the government as terrorist, and then allow it to imprison or deport him without trial, as it may already do with visitors or immigrants.

Other forms of due process have also been undermined. If the prisoner in a terrorist case does gain access to a lawyer, the government has already unilaterally asserted the right to listen in on anything said between the two, in effect destroying lawyer-client confidentiality, one of the pillars of a fair trial. And there is also the much-touted plan for military tribunals. These could, according to the presidential order setting them up, apply to millions of legally resident aliens in the United States, though not to citizens.

• **Resisting oversight.** The most persistent complaint about the Bush administration's efforts to expand its powers is its desire to escape review by either Congress or the courts. Civil libertarians complain that Mr Ashcroft rammed the Patriot Act through Congress with little consultation. This is a trifle unfair: Democrats managed to change some things. More worryingly, the administration has repeatedly refused congressional requests to report on how the new law is operating, or to consult Congress about any new legislation, despite preparing a full draft of Patriot II.

Terror's victory

How much will the government's new powers help it to fight terrorism? Unless the FBI, the CIA and the police are extraordinarily inept, increased powers of surveillance and arrest should make it easier to catch some terrorists. Yet there is also reason to fear that the heavy-handed use of these powers could be counterproductive—particularly with immigrants and foreign-born Americans.

Ethnic profiling of Muslims is sensible after the September 11th attacks. But these are also the people whose co-operation could most help stop al-Qaeda. Many of America's 1.6m Muslims are nervous. Hundreds of Pakistani families, fearing deportation, inundated border posts last month seeking asylum in Canada. Nations on the new immigrant-registration list, many of them supposedly American allies, have protested their inclusion.

More broadly, there are some 18m legally resident aliens in the United States, an estimated 7m illegal immigrants, and a further 10m foreign-born citizens. Even on Mr Ashcroft's reckoning, hardly any of these people are terrorists. Most, like the waves of immigrants who came before them, are fervent believers in the American dream. Reducing the legal protections that all are entitled to is a blow to that dream, and a victory for the terrorists.

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Alan Greenspan and the economy

Irking the right

Mar 6th 2003 | WASHINGTON, DC
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Conservatives are fed up with the Fed chairman. He is not their only problem

Reuters

He can hear the whispers

ON MARCH 6th, Alan Greenspan, the chairman of the Federal Reserve, turned 77. Given his age, speculation about Mr Greenspan's departure from the central bank tends to spike around his birthday every year. This year is no exception. The pundits' tone, however, is different. Instead of reverentially dreading when St Alan will retire, conservatives are whispering it is time to martyr him now.

Mr Greenspan infuriated the right with a recent congressional testimony that was less than glowing about George Bush's latest $670 billion tax-cut plans. Though he spoke warmly about the benefits of eliminating the double taxation of dividends, a centrepiece of the plan, Mr Greenspan made the crass error of suggesting that tax cuts needed to be paid for and that budget deficits matter. Worse, he said the economy might not actually need a stimulus.

Heresy indeed. In a column “Is it goodbye for Greenspan?”, Robert Novak, a prominent conservative writer, suggested that the White House was so furious with Mr Greenspan that it was considering not reappointing him next year. Stephen Moore of the supply-side Club for Growth has argued that the “old ace” is tiring and it is time for a new pitcher. Grover Norquist, an anti-tax man, suggests that Mr Greenspan has “exhausted any reservoir of support” among conservatives. Things have got so bad that one Democratic senator, Charles Schumer, accusing the administration of “an ongoing orchestrated whisper campaign”, formally introduced a resolution in Mr Greenspan's support.

Is this a storm in a teacup or is Mr Greenspan really in trouble? Formally, his current four-year term as chairman of the Fed ends on June 20th 2004. He could be re-appointed for a further two years until his 14-year term as a governor is up in January 2006 (by which time he would be almost 80). By all accounts, Mr Greenspan loves his job and would be keen to stay on.

Mr Bush's calculation is less clear. Ideally, he would like to appoint his own man to the post. Even before the tax-cut spat, Mr Greenspan was not a natural friend. The central banker's refusal to cut interest rates in 1992 is blamed by many Bush acolytes as a reason for the defeat of George Bush senior. On the other hand, both the timing and Mr Greenspan's reputation make replacing him tricky. June 2004 is uncomfortably close to the presidential election in November. That suggests any change of Federal Reserve chairman must either take place soon, or wait until after the election.

Until recently conventional wisdom held that Mr Greenspan could stay on if he so chose. Firing St Alan

would simply shock the markets too much. But as the economy remains slack, that reputation is dulling, and not just among conservatives.

Much depends on finding a credible successor. Glenn Hubbard, who resigned as chairman of the Council of Economic Advisors (CEA) last week, is widely mentioned as a young, but possible, successor. Best odds, however, go to Martin Feldstein, a Harvard economist who was chairman of the CEA under Ronald Reagan. Mr Feldstein famously clashed with Mr Reagan's supply-siders, but he has recently gone out of his way to argue that the economy needs more stimulus, and to praise Mr Bush's proposed tax cuts.

This enthusiasm is not shared by many senators, who tend to espouse similar doubts to Mr Greenspan. Only one Democratic senator, Zell Miller, publicly supports Mr Bush's tax plan, and several Republicans are sceptical about huge tax cuts at a time of soaring deficits. To the conservatives' chagrin, these moderate Republicans are also cool about Mr Bush's plans to reform Medicare by offering old Americans prescription-drug benefits in return for joining managed-care organisations. In a striking climb-down, Mr Bush this week touted a watered-down Medicare reform proposal that offered some prescription-drug benefits to old people who stayed with the existing system.

On tax policy, the White House has so far refused to negotiate. Instead, Mr Bush's economic team has begun a huge lobbying blitz. Corporate bosses, for instance, have been enlisted to send letters touting the dividend tax cut along with their shareholders' dividend cheques. John Snow, the new treasury secretary, claimed this week that eliminating taxes on dividends would buck up the stockmarket. The idea is to get investors to pressure those recalcitrant lawmakers. But with budget deficits soaring and the costs of an Iraq war yet to come, the White House may be the one that has to retreat.

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The Estrada fight

A war over two Latino lawyers

Mar 6th 2003 | WASHINGTON, DC
From The Economist print edition

“Playing politics”, snorts the White House. It is, indeed

AP

Estrada smiled and said nothing

ONCE again, the Senate is engaged in hand-to-hand combat over judges: this time over the nomination of Miguel Estrada to the federal Court of Appeals for the District of Columbia. The Republicans have enough votes, 50, to get Mr Estrada confirmed. But they don't have the 60 they need to break a Democratic filibuster.

As *The Economist* went to press, the Republicans were trying to break the filibuster through a technical (and somewhat disgusting sounding) procedure called “cloture”. In practice, this means having a vote to force Democratic opponents to come out in the open to be shamed. The Republicans intend this to be the first of many such procedures.

Both sides are being stubborn, which stops other business and poisons the club's normally gentlemanly atmosphere. The Republicans accuse the Democrats of nothing less than subverting the constitution. The constitution gives the president the power to nominate judges “with the advice and consent” of the Senate, they argue; the Democrats are trying to establish a 60-vote threshold for judicial nominees.

The Democrats accuse Mr Estrada of what might be called “strategic terseness”. His answers during his Senate confirmation hearing were so sphinx-like that it was impossible to tell what he thought about controversial legal subjects such as abortion. (Mr Estrada says he does not want to be seen to be prejudging cases that might come before him as a judge.) The White House has refused Democratic requests to release Mr Estrada's memos from his years in the solicitor-general's office. One Democratic senator, Charles Schumer of New York, accuses Mr Estrada of being a “stealth” conservative; another, Edward Kennedy of Massachusetts, says that “the fundamental rights of the American people are too important to be entrusted to a person about whom we know so little.”

The battle is spreading beyond Washington. Republicans have held pro-Estrada demonstrations around the country, including a rally in Miami and candle-lit vigils in San Francisco and Los Angeles. They have paid for pro-Estrada advertisements on Spanish-language television in several states. So far, four Democratic senators (including Florida's Bill Nelson) have said they will vote for Mr Estrada.

Why all this fuss? The District of Columbia circuit is widely regarded as the second-most important court in the land, because it rules on the constitutionality of federal laws and regulations, and resolves disputes

between the executive and legislative branches. It is also a stepping-stone to the Supreme Court.

The fact that Mr Estrada is a Latino adds to the stakes. He is part of the country's biggest minority—and one that is much less wedded to the Democratic Party than blacks are. George Bush won about a third of the Latino vote in 2000, and some Republicans think that a noisy battle over Mr Estrada's future could help their cause.

Mr Estrada, they say, is an embodiment of the American dream: a Honduran who came to the United States at the age of 17 with a limited command of English but nevertheless graduated from Columbia University and Harvard Law School. His legal curriculum vitae is also good: he was an editor of the *Harvard Law Review*, worked for a Supreme Court judge, was named as an assistant US attorney by George Bush senior, and was promoted to assistant solicitor-general by Bill Clinton. He has argued 15 cases before the Supreme Court. His supervisor in the Clinton period has praised him as a “model of professionalism and competence”. The American Bar Association has given him its highest rating. Republicans claim that the Democrats' attempt to block his nomination proves that they will allow Latinos to get ahead only if they toe the party line.

In fact the White House may have a subtler agenda. Gregory Rodriguez of the New America Foundation argues that Mr Bush is less concerned about Mr Estrada than he is about another Latino, Alberto Gonzales, the White House counsel. The composition of the DC circuit court is hardly a topic of conversation in the suburbs of Los Angeles and Houston. The fact that Mr Estrada is a Honduran limits his appeal to the two-thirds of Latinos who hail from Mexico. Mr Estrada is too conservative and too young, at 41, to have any chance of a seat on the Supreme Court.

Mr Gonzales, on the other hand, is an ideal candidate for the Supreme Court. He is a Mexican-American whose father did two jobs in order to feed his wife and eight children, and a moderate Republican who speaks with great delicacy on controversial subjects like affirmative action. He has long been on close terms with Mr Bush. By fighting Mr Estrada's appointment to the federal court so fiercely, the Democrats are making it less likely that they will be able to resist Mr Gonzales's elevation to the Supreme Court in a year or so.

Mr Bush has warned the Democrats against “playing politics” with the Estrada nomination. In fact, the nomination is an example of the White House itself playing politics, and doing so most efficiently. If the Republicans get their way, they add a solid conservative to the federal court; if they fail, they paint the Democrats as filibuster-loving obstructionists and enemies of Latino advancement. Either way, the fight makes it easier to get Mr Gonzales a seat on the highest court in the land.

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Texas taxes

Blowing up the Delaware Sub

Mar 6th 2003 | AUSTIN
From The Economist print edition

Or, when is a new tax not a new tax?

Get article background

HEARD of the “Delaware Sub” loophole? Perhaps you should have done. At a time when Texas's ruling Republicans face a $10 billion budget shortfall, and are desperate not to violate a pledge of no new taxes, it is the most tempting target around.

It works like this. Joe's Texan Widget Corporation, whose shares are publicly traded on Wall Street, gets fed up with its state tax bill. So Joe creates two out-of-state (usually Delaware) subsidiary corporations, or “subs”, and makes them partners in a business structure known as a Texas limited partnership—the same kind of tax-sheltered entity that George Bush used when he took over the Texas Rangers baseball team. Joe's former corporate customers and employees are then transferred to the partnership, and presto!—the 96-year-old Texas “franchise” tax on corporations no longer applies.

This capacious dodge has been around for years, but recent tax and legal changes have made it more attractive. Now more and more huge companies, including Dell Computer and SBC, formerly Southwestern Bell, are making use of it. Since 1998, when just 54 companies converted to the hybrid structure, some 3,906 have opted out of Texas business taxes, according to the state comptroller. The loophole saves SBC alone $30m-50m a year, and in the next two fiscal years, if matters stay as they are, it will cost the Texas state treasury an estimated $360m. But shutting the loophole, depending on how a bill is drafted, might bring in much more.

Would it mean, in effect, a new tax? The Republicans say no; closing the loophole merely means that corporations have to go back to paying a tax they were paying before. Or, as Governor Rick Perry recently declared, “It's not a new tax if you should have been paying it all along.”

Besides, the state's would-be budget-balancers have tried almost everything else they can think of—short of imposing a personal income tax, which may come when hell, or at any rate Houston, freezes over. State agencies are proposing a list of fearsome spending cuts: ending health-insurance coverage for 250,000 children, denying life-saving drugs to AIDS patients, even releasing juvenile prisoners early. In comparison, eliminating the “Delaware Sub” seems painless. “We've got to raise money. We've got to have some revenue to balance our budget,” says Yvonne Davis, a Democrat who has sponsored the bill.

But don't expect the companies to take it lying down. Dell and SBC are said to be quietly organising a lobbying effort to keep the loophole on the books. They will have support from the still-powerful oil and gas industry, where plenty of companies exploit it. Ben Sebree, vice-president for governmental affairs at the Texas Oil and Gas Association, says his industry already pays plenty in sales, property and drilling taxes, and will mount a “vigorous”' campaign to keep the partnership law unchanged. Moreover, he does not agree with Governor Perry's logic. “If you legally didn't pay the tax,” he says, “and they change the law and you're suddenly subject to the tax, that's a new tax.”

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Michigan's garbage trouble

Load of rubbish

Mar 6th 2003 | LANSING, MICHIGAN
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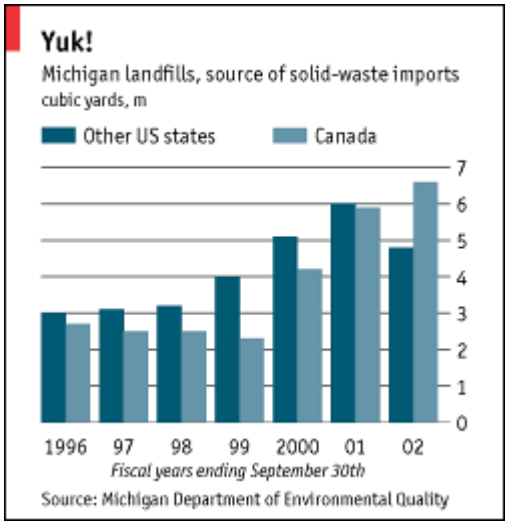
Look at Canada, and hold your nose



IT WAS all the broken hockey sticks and empty cans of maple syrup that finally caused Michigan to revolt. The state is having a fierce spat with neighbouring Canada on the messy subject of garbage imports. The Canadian city of Toronto, which has shipped much of its muck to Michigan in recent years, began sending all its solid waste there on January 1st after its own landfill had, well, filled up. About 200 truckloads of Canadian trash, from Toronto and elsewhere in Ontario, arrive in Michigan every day. That is on top of the garbage from fellow American states such as Illinois, Indiana and Ohio.

Michigan's politicians say this must stop. “Our state cannot—and will not—be the nation's trash can,” Governor Jennifer Granholm proclaimed last month. Things have not been helped by a report that a lorry was stopped at the border last autumn when customs agents saw blood dripping from it. It apparently contained medical waste, a banned import.

Michigan's Department of Environmental Quality insists the issue is a tempest in a garbage bag, pointing out that 80% of solid waste going into landfills last year was Michigan's own and that total waste fell by 5% last year. All the same, its figures show that the state's garbage imports more than doubled between 1996 and the year ending last September, when 11.4m cubic yards arrived (6.6m from Canada). Pennsylvania gets even more, but Michigan is expected to surpass Virginia this year as the country's number-two recipient.

Congressman Mike Rogers, a Michigan Republican, has put forward a bill that would give states the authority to ban or limit foreign garbage (this is currently a federal job). He says it is not just the possible poison he is worried about. Many of Michigan's big firms, including car makers, are just-in-time manufacturers, and the garbage trucks clogging the roads from Canada are hurting their business. The burly ex-FBI agent also raises security concerns about what might be hidden inside all those containers. But his bill is opposed by free-trade lobbyists, landfill operators and congressmen from trash-exporting states.

It strikes many as odd that wide-open Canada should send so much garbage to America. Steve Whitter, Toronto's director of solid-waste operations, says it chose Michigan landfills after it failed to find an alternative in Ontario. He adds that Michigan sends even nastier things northwards: it exports about 13 times as much hazardous waste to Canada, he claims, as the other way round.

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Lexington

The great uniter?

Mar 6th 2003
From The Economist print edition

George Bush's policy has become one of divide and conquer. It is working—for the moment

"I'M A uniter, not a divider." That was George Bush's boast in the 2000 presidential election. He promised to "change the tone in Washington" by bringing back civility to domestic policy. He also said his "humble but strong" foreign policy would improve America's relations with the rest of the world.

These ambitions lasted about five minutes. Mr Bush's first tax cuts passed the House of Representatives with a mere ten Democratic supporters. Things improved a little after September 11th, when the need to show a patriotic united front prevailed, but partisan warfare has since returned with a vengeance. The president is pushing for a second round of tax cuts, the appointment of anti-abortion conservatives to judgeships and the rolling back of affirmative action—all things that make Democrats seethe and weep. As for endearing his administration to foreigners through humility, well, let's just say that it did not go entirely to plan.

The great uniter presides over a transatlantic relationship that is going through one of its roughest patches for a long time. Most non-Americans are strongly opposed to a war in Iraq, hostile to the president, and increasingly critical of America itself. At home, despite an impressive Republican performance in the mid-term elections, public opinion has moved comparatively little. Although Mr Bush's own ratings remain reasonably high, they too follow the party line. Among Republican voters, he is as popular as any president has ever been at this stage, Ronald Reagan included. But only one in four Democrats looks favourably on his performance, an unusually low figure. If Mr Bush was serious about being a uniter, he has failed.

In the short run, this record of division has not hurt him that much. Of course, the president has not lived up to those promises of being a uniter. But the dreams of campaign-time often go pop. Washington politics was anyway becoming more partisan before Mr Bush became president. He has continued a trend, but has also exacerbated it.

Anyway, this divisiveness has yielded short-term benefits. Mr Bush has split not only his country but also his critics. Some Democratic presidential candidates approved the congressional resolution on the use of force against Saddam Hussein last year; others vehemently oppose military action in Iraq. Some Democrats voted for tax cuts in the Senate; the party rank-and-file dislikes them. It is the same story with the transatlantic alliance. New and old Europe have split on the merits of war against Saddam, and, as with the Democrats, this has helped Mr Bush.

So why should he worry? The answer has to do with the extraordinary ambition of his plans and the inevitable difficulties of sustaining them. At home and abroad, he is rolling the dice in the expectation of gains far off into the future.

In domestic policy, Mr Bush's justification for tax cuts has changed so often that it is easy to lose sight of his real motives. The administration makes much of the idea that the cuts will increase demand in the short run. But there are plenty of speedier ways to inflate the economy. Mr Bush's tax-cut strategy is at heart a more ideological gamble on the future: he argues that lower taxes and a simpler tax structure will make the economy more efficient in the long run—meaning eight, ten, 20 years out.

Something similar applies to Iraq. Mr Bush is on the verge of committing America to an immense enterprise. Toppling Saddam Hussein would be a big step in the campaign to halt the spread of weapons of mass destruction and ensure they do not fall into the hands of terrorists. And, as he made clear in last week's speech to the American Enterprise Institute, it would be an earnest of America's commitment to the democratic transformation of the Middle East, which would help to solve the Israel-Palestine problem. But this too will take years, even decades.

The vision has to be seen by the others

The fact that Mr Bush is looking so far into the future is in many ways admirable. But it casts a shadow of doubt over his divisive tactics. For in both domestic and foreign policy, the president is committing America to a long haul without doing the work needed to prepare people for the setbacks that will be inevitable along the way.

At home, the economy is sputtering. It could even fall back into recession. At some point, criticism of the tax cuts seems likely to grow louder. Having sold the cuts with a bewildering variety of arguments—the budget surplus means we can afford them; they will give the economy a short-term fillip; budget deficits don't matter anyway—Mr Bush will find it harder to persuade the public that they are a good idea in the long run, not just a boondoggle for the rich.

Abroad, everyone hopes that a war in Iraq, if it comes, will be swift and relatively merciful. But there is no guarantee that it will. And it seems highly likely that the subsequent reconstruction of Iraq will be extremely difficult—and the political transformation of the Middle East harder still. So was it sensible of Mr Bush to wait until the last minute to start talking about long-range political transformation? And then to do so in vague, cliché-ridden terms? Was it shrewd, given that such an ambitious transformation cannot be managed by America alone, to do so little to advocate an Israeli-Palestinian peace in the meantime? Or to irritate many Europeans so casually on everything from the Kyoto protocol to jibes about “old Europe”?

Mr Bush has fallen prey to a besetting fault of his administration. Serious discussions do take place in the White House—but their seriousness often does not carry over into the realm of public persuasion. The president too easily assumes that, if the policy is right, people will come to see its wisdom. They may well do so, eventually. But in the short run doubt and suspicion continue. And that makes it harder than it need be to sustain the admirably ambitious policies Mr Bush has embarked upon.

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The Andean drug industry

The balloon goes up

Mar 6th 2003 | BOGOTA, LA PAZ AND LIMA
From The Economist print edition

The "success" of Plan Colombia in cutting coca production has started to undermine governments farther south

Get article background

"A TURNING point" is how John Walters, the director of the United States' office for drug control, jubilantly described figures released by his government last week, which claimed a 15% fall in 2002 in Colombia's crop of coca, the plant used to make cocaine. This follows eight years of steady increases in the amount of land under coca in Colombia, the source of three-quarters of the world's cocaine.

For American officials, last year's fall is evidence that "Plan Colombia", a programme of mainly military aid begun by Bill Clinton and continued by George Bush, is starting to pay off. Under this plan, the United States has provided Colombia with extra helicopters and crop-dusting planes to spray coca with herbicides. Most of these have finally arrived, and Álvaro Uribe, who became Colombia's president last August, has been happy to use them: he has unleashed a massive spraying campaign which officials say is at last outpacing the ability of coca farmers to replant.

Yet there is a hollow quality to this victory. Over the past three decades, rich-country demand for cocaine has created a monster in the Andean countries. The illegal-drug industry has corrupted institutions, distorted economies, wrecked forests, and financed armed groups such as Colombia's FARC guerrillas and right-wing paramilitaries. But the "drug war" has imposed its own costs. One is known as the "balloon effect": local squeezes simply move the industry elsewhere, spreading violence and corruption with it.

Thus, in a reversal of a trend begun a decade ago, drug production is rising in Bolivia and Peru, and this year coca farmers there have mounted new challenges to governments; this "politicisation" of the coca industry is "most troubling" admitted Mr Walters. This shift comes at a delicate juncture: weak economies, weak governments in several countries, political conflict in Venezuela and Bolivia, and Colombia's intensifying wars have all aroused fears about the Andean region's stability.

A second worry concerns the figures themselves. Mapping the coca crop is difficult, and not everyone trusts the American figures. But the trend is clear enough. The UN will next week publish its annual coca census, which is more comprehensive than America's sampling. Having reported an 11% fall in Colombia's coca area in 2001 to 145,000 hectares (358,000 acres), the UN is expected to reveal an even steeper fall for 2002. But its estimate for Peru (46,700 hectares in 2001, with a small increase last year) is higher than America's. The UN also reports that more productive coca varieties are being used in both countries; in Peru it reckons that fields may be producing 10% more coca than a year ago.

Nevertheless, the shrinking of coca land in Colombia will comfort the United States' Congress. It is anxious to see some return from aid to Colombia of around $500m a year. That is especially true after FARC last month shot down an American spy plane apparently on an anti-drug mission, killing one American and taking three hostage. Even so, American officials believe this year will be better still: Mr Uribe has pledged to spray 200,000 hectares. If that happens, Mr Walters thinks, coca farmers will despair of profit and give up. He told Congress that America had “an unprecedented opportunity to seriously reduce the availability of illegal drugs”. Klaus Nyholm, the UN's drugs man in Colombia, says better prices for legal crops are helping: excluding drug crops, the country's farm output expanded by 3.5% last year, double the growth of GDP.

The results are a fillip, too, for Mr Uribe, who faces mounting urban terrorism by the FARC. Some of Colombia's most drug-infested areas are close to giving up coca. Putumayo, where the UN reported 66,000 hectares in 2000, can eliminate the crop by December, says a local official. But the UN reckons it is spreading to smaller plots (to evade spraying) and that output is rising in other areas, such as Guaviare. Mr Nyholm says coca will not be eradicated until Colombia's wars end.

Fears of retreat

The guarded optimism in Colombia is mirrored by increasing problems farther south. In recent years, Bolivia was the drug warriors' success story. Between 1997 and 2001, its government eradicated 40,000 hectares of coca in the Chapare, the main growing area; aid money trickled in for alternatives, such as bananas. But American officials are now nervous about a retreat. In the past two years, new planting has outstripped eradication. And increasing amounts of Peruvian semi-processed cocaine-base are now being smuggled through Bolivia to Brazil and thence to Europe. Cobija, a poor northern outpost, has acquired sudden wealth; locals report an influx of heavily-laden, armed “backpackers” from Peru on the logging trails in the surrounding forest.

This year, Bolivia's powerful coca growers' movement has drawn blood against a weak government. Evo Morales, the movement's leader, was emboldened by winning 21% of the vote in last year's presidential election. To head off protests, President Gonzalo Sánchez de Lozada offered to expand the area in which coca can be legally grown for traditional uses (such as chewing and tea) if a study of demand showed this to be justified. To no avail: in January, protests by coca farmers brought much of the country to a standstill for two weeks. Mr Morales played no direct role in violence last month, in which 33 people were killed in riots and clashes between striking police and the army. But these events have left Mr Sánchez (who claims there was a plot to kill him) in no position to take the offensive against coca.

In Peru, too, the politics of coca has become more confrontational. Until the mid-1990s, Peru was the world's main source of the shrub. But the price of coca has been climbing again since 1998, and production rising. Worried about the backflow from Plan Colombia, American officials have stepped up aid to Peru, while also pressing for a tougher policy. In September, the government said it would begin forcible eradication in hard-core coca areas, a policy Peru eschewed in the late-1980s, after Shining Path terrorists exploited discontent over it.

The response was a wave of violent unrest in traditional coca-growing areas. More than 70 people were injured in an 11-day “strike” last month; in Aguaytía, protestors smashed up the government's anti-drug office, burning equipment. For the first time, the coca growers may have a political leader, albeit not with the clout of Mr Morales in Bolivia: Nelson Palomino, who was recently arrested on charges of supporting the (much weakened) Shining Path, something he denies. His arrest was greeted by a protest by thousands of coca farmers in Ayacucho, the Shining Path's birthplace. Such protests are a novelty for Peru. The farmers have now called a three-week “truce”: they want the government to agree to an end to forced eradication and more money for development schemes.

Further afield, there are other worrying signs. This week, Rio de Janeiro's carnival took place under the eye of the army: on its eve, the city's leading drug gang bombed buses and buildings, its second such

show of strength against an ineffective state government in five months. And following tougher action by Mexico, more drugs now flow to the United States through Caribbean islands, as they did in the 1980s. The drug industry has an unerring eye for institutional weaknesses. As long as cocaine is demanded, victories over it involve defeats elsewhere.

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Chile

Seeking inspiration

Mar 6th 2003 | SANTIAGO
From The Economist print edition

Opportunities missed—and unwanted

Get article background

HALFWAY through his six-year term, President Ricardo Lagos needs a pick-me-up. Neither a lacklustre economy nor two corruption scandals are his fault. But they have left his government looking limp. A long-awaited cabinet reshuffle promised a cure. But it has merely shown how little scope he has for innovation.

In all, Mr Lagos's centre-left coalition has been in power for 13 years. It lacks new faces, and relations between its four constituent parties have become tense and jealous. So in the reshuffle on February 28th, Mr Lagos's senior ministers all kept their jobs. Seven out of 17 ministers were replaced. But the only new blood is at the justice ministry. It went to Luis Bates, who previously ran the local branch of Transparency International, an anti-corruption watchdog.

Mr Lagos can point to achievements, including an unemployment insurance scheme and free-trade agreements with the United States and the European Union. His government's underlying problem is that it now lacks an agenda to reinvigorate the coalition. Its microeconomic reforms appeal less to its own voters than to business. Its plans to modernise the state are worthy but dull. Similarly, its health reform is well-intentioned but incomprehensible to ordinary Chileans.

They will take more notice of Mr Lagos's line on Iraq: Chile is currently a member of the UN Security Council. That is a responsibility with which the government now feels uncomfortable. Like Mexico, a fellow council member, Chile dislikes war but is wary of angering the United States—because, in its case, its trade deal has yet to be ratified. So far, Chile has slipstreamed behind Mexico in common indecision. In the end, it may swing behind George Bush. But that will do nothing to inspire Mr Lagos's jaundiced supporters at home.

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Argentina's economy

Defaulter of last resort

Mar 6th 2003 | BUENOS AIRES
From The Economist print edition

Savers get dollars, sort of

Reuters

Justice for savers, not taxpayers

Get article background

IN JANUARY 2002, when Eduardo Duhalde, Argentina's interim president, bowed to the inevitable and devalued the peso, he faced a problem. Argentina's economy was largely dollarised: 70% of bank deposits and 79% of loans were in greenbacks. Since devaluation would thus mean bankruptcy for many debtors, Mr Duhalde decreed that dollars should be converted into pesos. To try to mollify angry depositors, there was a twist: while most loans were switched at par, deposits were converted at 1.4 pesos to the dollar. It was a mess, and it has come to haunt him.

As the peso plunged (it now stands, somewhat stronger, at 3.18 to the dollar), some 180,000 depositors filed lawsuits against the decree. On March 5th, in a test case, the Supreme Court ruled that conversion to pesos was illegal. Savers rejoice at what they see, rightly, as a victory for property rights. They will now rush to claim dollars—and will be frustrated not to get them. Deposits worth at least $12.5 billion are involved, assuming the ruling is not applied to those already withdrawn. The banks lack the money. So the government will have to issue bonds to cover the difference.

There is expensive irony in all this. The IMF had long pressed the Argentine government to convert frozen savings deposits into bonds; it had resisted, partly out of fear the courts would disapprove. And the vocal campaign for the restitution of dollar deposits has not extended to dollar loans: many borrowers quietly paid these off in devalued pesos.

Messy though the process was, some economists claim there was a rough justice in “pesification”. Under its complex rules, deposits (many of which have been frozen since last year) were indexed to inflation. All told, savers would get back 67 cents to the dollar. The average term of savings deposits was five years;

before the devaluation, they had received high interest rates. So the typical saver would have done no better had he deposited the money in Miami, points out Javier Gonzalez Fraga, a former governor of the central bank.

Now, the savers' losses will be transferred to the taxpayer. Argentina's government defaulted on its foreign bonds last year. But that has not deterred it from issuing new debt. Already, it has given the banks bonds to make up for the differential treatment of their assets and liabilities. Now the banks will receive yet more government paper of uncertain value.

Argentina is due to elect a new president next month. Chaos at the banks would not help Néstor Kirchner, Mr Duhalde's favoured candidate. But the return of dollar savings was backed by Carlos Menem, his main rival, who when he was himself president packed the Supreme Court with friends. Mr Duhalde can only rue his hamfisted effort to devalue without pain.

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Brazil's new politics

Compromising idealists

Mar 6th 2003 | BRASíLIA
From The Economist print edition

The Workers' Party battles to turn dreams into policies

Get article background

IN JANUARY Brazil's education ministry spent 760,000 *reais* ($221,000) on post, 147,000 *reais* on travel and 6,000 *reais* on bottled water. The money, complains Cristovam Buarque, the education minister in Brazil's new left-leaning government, was spent not by schools but by the bureaucrats at headquarters. A hundred university rectors descended on him in his first 40 days as minister. Municipal officials responsible for primary education, one of the government's top priorities, “never ask to be received”, laments Mr Buarque, himself a former rector.

Reuters

Society is civil enough, Congress less so

Idealism and impatience with government-as-usual are much on display in Brasília, two months into the government of Luiz Inácio Lula da Silva, a former trade-union activist. The *petistas*, as members of Lula's Workers' Party (PT) are called, are struggling to master the machinery of government without being compromised by it. And they are trying to correct what they regard as Brazil's misguided course while having to rely on many of the people who plotted it.

They are a relatively inexperienced bunch, having previously run nothing bigger than Brazil's fourth most-important state. But they are eager learners. “There is a total openness to knowledge,” says Vinod Thomas, who heads the World Bank's Brazil office. To find talent, the government has poached so many activists from “civil society” that NGOs are having trouble recruiting. Even so, of 24,000 senior jobs in the president's gift, only 500 have so far gone to *petista* recruits, estimates Walder De Góes, a political scientist.

The idealism sits alongside pragmatism and compromise. That is already a taunt from centrists, and a bitter accusation from the PT's own left wing. Lula has submitted to the financial orthodoxy of his predecessor, Fernando Henrique Cardoso, raising interest rates and chopping the budget to stabilise inflation and debt. His top priorities for reform—pensions and taxes—were Mr Cardoso's too. The *petistas* have struck deals with “oligarchs” whom they once reviled. José Sarney, a former president and backwoods political boss, became president of the Senate with the PT's backing. “Maybe Lula fell into the trap of seeking power for its own sake,” worries Luciana Genro, a dissident PT congresswoman.

Her comrades in government see themselves as compromising without being compromised. If political pacts are needed to tame congressional oligarchs, a new “social pact” will bring the powerless into policymaking and persuade the powerful to rise above narrow interests. “Dialogue with civil society is as

important as parliamentary politics, but not a substitute for it", says Luiz Dulci, a member of Lula's inner circle. The main reforms will be discussed by a Council of Economic and Social Development, which brings together politicians, unions, business and NGOs, before going to Congress.

Much of this smacks of the need of the PT's leaders to persuade their rank-and-file to back policies they have long opposed. But congressmen worry that they are being bypassed. Not so, swear Lula's men. In private, however, the mistrust is mutual. "Congress is basically conservative," says a senior *petista*.

Mr Cardoso drafted reforms, then invited debate; Lula talks first and drafts later, notes Mr De Góes. This is time-consuming, and risks squandering the honeymoon on which Lula depends to enact his main reforms. It has borne some fruit: on February 22nd the president persuaded 27 state governors to sign the "Brasília Charter", outlining a consensus on pension and tax reform. But the real test will be what happens when the consensus lands on congressional desks.

Rather than chopping civil servants' pensions, what galvanises *petistas* is a yearning to shrink Brazil's social and economic inequalities, a project they sense has a global audience. They see themselves as the most visible of the world's democratically-elected "progressive" governments. Success would vindicate both democracy and progressivism.

What sort of progressivism? "We are a party of attitudes rather than a party of ideas," says Mr Buarque. He admits that so far the PT has offered Brazil no blueprint. He proposes "liberal socialism", a free-market economy coupled with robust public services such as education. This hybrid is more or less what the government has been forced to adopt by Brazil's precarious finances. But it may not satisfy *petistas*, who class the markets with the oligarchs as forces requiring their guidance.

Antônio Delfim Netto, a conservative congressman, describes the shift in development philosophy in Brasília thus: the Cardoso team saw comparative advantage as "an act of God"; Lula's government thinks it can be created. This hope inspires Brazil's advocacy of protection for "infant-industries" in the proposed Free-Trade Area of the Americas. Ministers want to direct spending on government nutrition programmes to family farmers, promoting two of their favourite causes at once. Too much of this could easily turn into old-fashioned *dirigisme*. But, for the moment, this risk seems small. The *petistas* are as pragmatic as they are idealistic.

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India's economy

A budget for votes, not reform

Mar 6th 2003 | DELHI
From The Economist print edition

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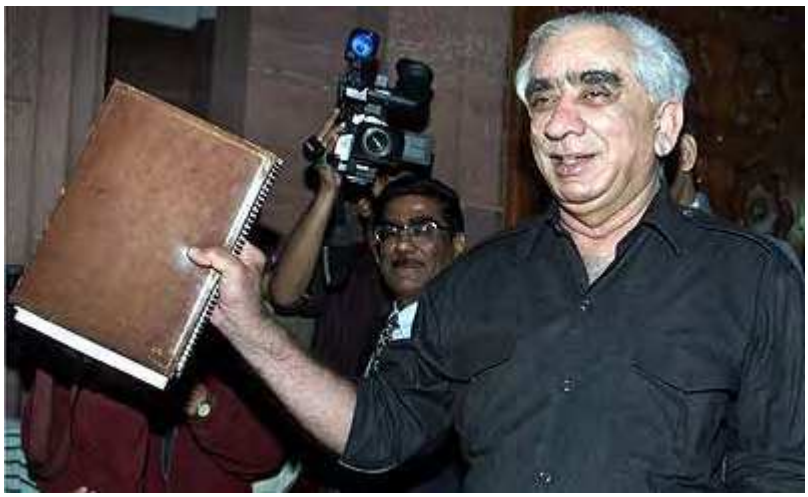


Jaswant Singh's first budget represents a lost opportunity for India

FEW finance ministers have the good luck to find their budgets drowned by unconfined national rejoicing. When he unveiled his plans to parliament on February 28th, Jaswant Singh could not have known that a day later triumph over Pakistan in a cricket match would light fireworks across the country. Only the opposition and curmudgeonly economists played party-poopers, stubbornly demanding to know how long his government can keep deferring a serious effort to plug the cavernous hole in its finances.

Mr Singh played his innings against distracting background noises. The martial drumbeat from the Gulf recalled India's harrowing experience in 1991, the last time the world took on Iraq: economic slump and national bankruptcy. Closer to home, there was the heckling of politicians ahead of a spate of electoral contests, including a general election due by October next year.

The government's Economic Survey, published just before the budget, had recorded a year of chugging-along in adverse circumstances. The countryside, where 70% of the population live, has been afflicted with one of the worst droughts in decades, affecting nearly a third of the country. Agricultural production, still about a quarter of Indian output, is forecast to have fallen by 3.1% in the fiscal year that began in April 2002.

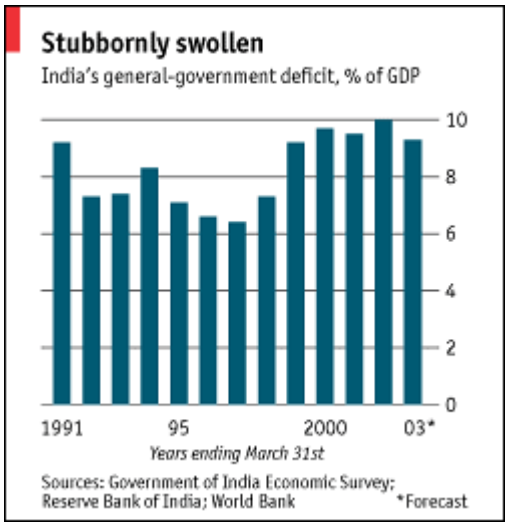
Yet the economy will still have grown by 4.4%—a snail's pace when compared, as it usually is, with China (especially if the official figures are to be believed), but not bad against most other yardsticks. Industry and services are both growing faster than before (at annual rates of 6.1% and 7.1% respectively), exports are up by a fifth, and the current account, after 24 years in the red, entered surplus in 2001.

Mr Singh was moderately generous, tinkering with direct-taxation allowances and with excise duties. The urban middle class will be a prime beneficiary, as befits an important constituency for Mr Singh's Bharatiya Janata Party. They will have more money in their pockets; and cars, air-conditioners and imported booze will all be cheaper.

But the government's critics worry that Mr Singh has not done enough to trim the public-sector budget deficit, which has been running at around 10% of GDP for the past five years (see chart). The World Bank and others have been worrying about the deficits for years. “They may result in higher inflation,” fretted a recent Bank report, “push up interest rates, further crowd out private investment, weaken the

health of the financial system and increase vulnerability to macroeconomic risks." And so they may. But for the time being inflation is subdued, interest rates falling, banks hungry for government debt, foreign-exchange reserves ballooning and external borrowings modest.

So Mr Singh, who was presenting his first budget since becoming finance minister, faced no really compelling pressure for radical surgery. He delayed the overhaul of the tax system recommended in the recent report of a government-appointed committee, though he agreed with it that the present regime is "exemption and discretion based", making it "suspicion-ridden, harassment-generating, coercion-inclined" ("corruption-riddled", too, he might have added). But moves towards a simpler, more efficient approach that might also generate more revenue were, he lamented, "difficult to achieve in one leap". In fact, his budget does less to widen the tax net and simplify the rules than it does to magnify the network of loopholes and opportunities for "discretion".



There were some sops to those keen to see renewed momentum behind the liberalising reforms undertaken after the 1991 crisis. More industries were removed from the list of those "reserved" for small companies. Foreigners will be allowed to own majority stakes in banks. The government-set interest rates paid on "small savings" deposits were lowered, cutting the cost of subsidising them, and freeing the central bank to reduce its own rates. Budgeted revenue from privatisation was increased, to 132 billion rupees ($2.75 billion), though most of this—from the sale of stakes in two oil companies—was in last year's budget as well, and failed to materialise. Most controversially, Mr Singh made a small dent in the subsidies poured into both food and agricultural inputs by raising the price of fertiliser. He was at once assailed on all sides for being "anti-farmer".

Mr Singh's supporters would argue that you cannot expect too much from a single budget. And it is true that India's finance ministers have been painted into a corner by their predecessors because of the cost of financing the deficit. In a country of a billion people, a quarter of whom live below the poverty line, interest payments are the biggest single expense, accounting, with defence spending and subsidies, for 60% of recurrent expenditure: capital spending is only 15% of the budget. That leaves little for health, education and infrastructure. A lavish-looking commitment to road and other projects worth 600 billion rupees was achieved largely by promising private investors' money.

The target in India's current five-year plan is for average annual economic growth of 8%, the minimum needed to create enough jobs for India's young. Impeccably orthodox, rhetorically at least, Mr Singh noted that "fiscal consolidation" is the "central pillar" of sustained growth. But like many before him, he seems more intent on short-term growth than on structural reform, in the hope that the former will make the latter less painful. The risk, distant though the prospect now seems, is that it will take a crisis to give radical reform another spurt.

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Pakistan

A timely arrest

Mar 6th 2003 | LAHORE
From The Economist print edition

The arrest of a top al-Qaeda agent is welcome news for General Musharraf

Get article background

Reuters

General Musharraf, back in favour

THE arrest on March 1st of Khalid Sheikh Mohammed, alleged to be al-Qaeda's chief of operations, by a joint FBI-Pakistan team has come as a huge boost not just to George Bush, but to Pakistan's president, Pervez Musharraf, as well. State-controlled television interrupted its coverage of Pakistan's nail-biting World Cup cricket match with arch-enemy India to break the news. A grateful President Bush publicly expressed thanks to General Musharraf, for continuing to "lead" the war against terrorism.

All this is deeply gratifying for the general, and comes as welcome respite at a difficult time. In recent months, the America-Pakistan relationship has become dangerously strained, following leaked stories in the American press of a Pakistani hand in the development of North Korea's illicit nuclear programme. Allegations have also surfaced of Pakistan's secret support to pro-Taliban Pushtun elements in its tribal borderlands, who are conducting hit-and-run operations against America's forces in Afghanistan. And America is worried that the Pakistani government is doing less than it could to curb the infiltration of militants into Indian-held Kashmir, something that angers the Indians and provoked fears of a war between the two nuclear powers last year. General Musharraf has denied all these charges. But he admits to concern that if "anti-American elements at home"—a reference to the radical Islamists who are clamouring for a confrontation with America—and "anti-Pakistan agencies abroad"—a reference to India—had their way, Pakistan could be dragged into America's "axis of evil" along with Iran and North Korea after America has finished with Iraq.

More significantly, President Bush's praise for Pakistan's leading role in the war against terror may just give General Musharraf the opportunity to wriggle out of a perilous situation on the question of Iraq. Pakistan is currently a member of the UN Security Council, and its vote is sorely needed if America and Britain are to secure the nine positive votes needed to pass a resolution declaring Saddam Hussein in "material breach" of his obligations. But despite calls from Colin Powell, the American secretary of state, for support, so far General Musharraf has not committed himself. A wave of anti-Americanism has engulfed Pakistan and the Islamic parties are beginning to mount impressive street protests against any war in Iraq. Last Sunday, over 100,000 angry protesters in Karachi chanted slogans against America, burnt effigies of President Bush and warned General Musharraf that they would overthrow him if he supported "the great Satan". Under the circumstances, the government must hope it will be forgiven for abstaining rather than voting yes.

On the home front, too, General Musharraf is seeking to exploit his recent successes against al-Qaeda. Mr Mohammed was picked up from the house of a local-government councillor of the fundamentalist Jamaat-e-Islami party, whose leader, Qazi Hussain Ahmad, has been in the forefront of agitation against America and General Musharraf. Her son, one Ahmed Qadoos, appears to have given refuge to Mr Mohammed along with another alleged al-Qaeda Arab. This is the third occasion in recent months that an al-Qaeda terrorist has been nabbed in the house of a Jamaat activist or supporter. In January, two al-Qaeda men, Abu Omar and Abu Hamza, were arrested after a shoot-out at the house of the leader of Jamaat's women's wing in Karachi. A couple of Pakistani doctors, with alleged links to both Jamaatand al-Qaeda, have also been detained and questioned by the authorities. "The Jamaat has a lot of explaining to do", said Pakistan's prime minister, Zafarullah Jamali, this week, "for providing sanctuaries to terrorists".

Jamaat-e-Islami's weak denials are not cutting much ice. There is even talk in Islamabad of banning the party, which is the largest component of the Islamic opposition alliance. Although a ban is not considered likely, Jamaat's fiery and self-righteous posture is in danger of being made to look hypocritical or sinister. When the debate in parliament starts, in the next few days, about the position Pakistan should take in the UN Security Council, the government is sure to take great pains to remind the country about Jamaat's “connections” with terrorists, in an effort to draw the poison the Islamists will seek to direct against America and the general.

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South-East Asia's economies

If war comes...

Mar 6th 2003 | BANGKOK
From The Economist print edition

The region assesses the costs

VIETNAM, like most countries in South-East Asia, has expressed its opposition to an American war against Iraq. But if America ignores the protests coming from the region and presses on, Vietnam will have less to complain about than most. It is gathering a windfall from oil exports, thanks to a high price stoked in part by fears of war. It is also enjoying a boom in tourism, as skittish holidaymakers seek out safe destinations. As a regional economist put it, Vietnam is the hottest thing in South-East Asia at the moment.

The same factors apply in the rest of South-East Asia, but with the opposite effects. Singapore imports all its oil. Thailand and the Philippines import most of theirs. The high oil price is already fuelling inflation and singeing confidence in all three countries. This is particularly alarming for Thailand, which grew at a reasonable 4.6% last year on the back of a consumer boom. Even Malaysia and Indonesia, which export oil, will suffer in the longer run from the slowing world economy. In Asia there are very few winners from a high oil price in the medium term, says Arup Raha, an economist at UBS Warburg.

The uncertain political climate is also putting off tourists and investors. Various governments had already advised their people not to travel to Indonesia, Malaysia, Thailand and the Philippines after the bombing in Bali last October. This week's bombing of Davao airport in the southern Philippines, killing at least 21 people, will not have helped. Indonesia, the hardest-hit country, has already seen a plunge in both foreign investment and tourist arrivals. A war in Iraq would make things worse by raising fears of further terrorism or unrest in the region, especially in Muslim-majority countries such as Malaysia and Indonesia.

But the biggest risk for South-East Asia is that uncertainty about Iraq might weigh on countries elsewhere, and hence dent demand for the region's exports. During the previous Gulf war world trade slowed, particularly that involving America. Exports make up 40% or more of GDP for the big economies in the region. America is the biggest trading partner for most of them, and electronics the main export. Both America and the global electronics industry are in the doldrums. If they continue to stagnate South-East Asia will suffer.

All this might take as much as a percentage point off the region's GDP this year, depending on the duration of the current stand-off and the intensity of any subsequent war. The Thai and Malaysian governments are publicly fretting about meeting growth targets. Even Indonesia, the region's biggest oil exporter, will face slower growth if world trade contracts by 1% or more and oil prices rise by $2, according to a rough World Bank projection.

But the biggest loser will be the Philippines. Electronics make up almost 70% of its exports, and it sends 30% of them to America. It consumes more imported oil per dollar of GDP than any other country in South-East Asia. It suffers from terrorism, insurgencies and crime. Its ballooning public debt is already weighing on the economy. And it is the only country in the region with a direct stake in any war against Iraq. More than 1m of its citizens work in the Gulf countries, and help keep the economy afloat by sending much of their wages home. If a war sends them fleeing, the Philippines will have to cope with both a refugee crisis and a current account crisis. No wonder the peso and the stockmarket are under pressure.

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Cambodia and Thailand

The day peace ran out

Mar 6th 2003 | PHNOM PENH
From The Economist print edition

Rioting and political killings

FOR some four years Cambodia has had relative peace, stability and modest economic growth. Back in November, when ASEAN, the regional grouping, held its summit in Phnom Penh, people were saying that things had changed much for the better. A tourism conference in the capital early this year supported that view. The appalling events of January 29th, when Thai-owned hotels, offices and factories were burned and looted, made Cambodians feel insecure again. Subsequent developments have not been reassuring.

The anti-Thai fury was triggered by reports that a Thai television actress had insulted Cambodia with a reference to Angkor Wat, a Cambodian temple complex. The reports turned out to have been misleading. But by then the damage had been done. Thailand downgraded diplomatic relations with its neighbour and temporarily banned visits by Cambodians. Cambodia will receive a bill estimated at $50m for damage to Thai property. The prime minister, Hun Sen, has expressed regrets (though not apologised) to Thailand.

Who organised the mob, drummed up traditional Thai-Cambodian rivalries, and expertly guided the rioters to some 20 Thai targets? No one in the government is saying. Chea Sophara, the governor of Phnom Penh, has been sacked and has been moved to the dismal job of ambassador to Myanmar. Mr Sophara has been a popular governor and is assumed to have been made a scapegoat.

Many Cambodians would have liked to have seen the end of Hok Lundy, the national police chief, for failing to handle the mob and not protecting the Thai embassy. The much-feared Hok Lundy, who is a member of the ruling party's executive committee, made it clear he has no intention of being sacked in a speech to 300 police officers last week. He said any blame for the riots should be accepted by his superior, Sar Kheng, the interior minister.

A general election is due in Cambodia in July. Playing the anti-Thai card is seen by some as good tactics, but there is anyway a degree of political tension in Phnom Penh that makes people uneasy. Twelve key workers in Cambodia's three main political parties have been killed recently. Om Radsady, a top official in Funcinpec, the royalist party, was shot dead as he left a restaurant last month.

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China

What he did, and left undone

Mar 6th 2003 | BEIJING
From The Economist print edition

The mixed legacy of Zhu Rongji, China's outgoing prime minister

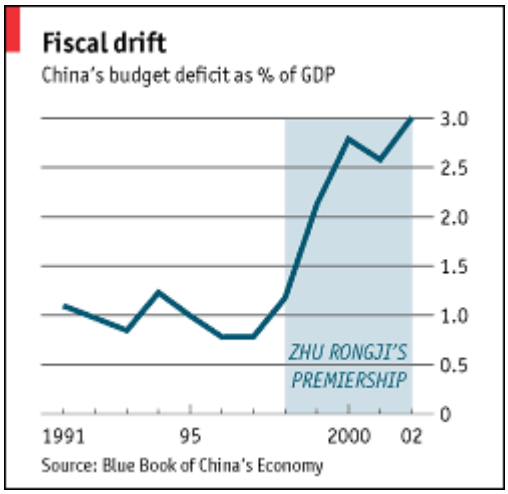
IN ONE respect at least, China's retiring prime minister, Zhu Rongji, has fulfilled his promises. In 1990, when he was mayor of Shanghai, he was asked by an American interviewer whether he was “China's Gorbachev”—a comparison much in use at the time among western journalists. “No,” Mr Zhu replied, “I am China's Zhu Rongji.” In his farewell speech to China's parliament on Wednesday, the 74-year-old Mr Zhu offered no hint that Gorbachev-style political reform had ever crossed his mind.

Mr Zhu's appointment in 1998 raised hopes in China and abroad of a sea-change in the way China's government would be run. His predecessor, Li Peng, was a stodgy, uninspiring conservative with little obvious enthusiasm for wrenching the economy out of the grip of the state and letting the market take control—or knowledge of how to do it. Mr Zhu came in fighting, pledging to slash bureaucracy, turn around the fortunes of ailing state-owned enterprises within three years and allow the state-owned commercial banks to operate independently.

But although Mr Zhu has made progress in some of these areas, the job is far from finished. In his 90-minute oration to 3,000-odd delegates in Beijing's Great Hall of the People at the start of the legislature's annual two-week session, he at least acknowledged that there were “outstanding difficulties and problems” which his successor (almost certainly Wen Jiabao, now a deputy prime minister) would face.

Take bureaucrats. Mr Zhu promised to cut half of the central government's staff, which he did (though some still draw state salaries in universities and think-tanks). But the far bigger bureaucracy in the countryside has continued to swell, resulting in growing friction between officials and the farmers whose taxes support them. Reform of state-owned enterprises (SOEs) has also seen mixed results. Mr Zhu managed to make some loss-making SOEs profitable by setting up asset-management companies that took over their debts and have been trying, with very limited success, to sell them. But this has done little if anything to improve the way the SOEs (or the state-owned banks) are run, and has done very little either to reduce the government's liabilities. Mr Zhu is often praised for keeping China's economy on track during the Asian financial crisis of 1997. But the pump-priming that has helped to keep the economy growing at 7-8% a year (according to official figures) has resulted in a fast-growing budget deficit (see chart). On March 6th, China's finance minister announced that this year's projected deficit would be 3.2% up on last year's record-breaking shortfall.

Mr Zhu did manage to force a recalcitrant bureaucracy to accept China's accession to the World Trade Organisation in 2001. But he would have won greater kudos among Chinese intellectuals and more reform-minded party members if he had pushed for greater political liberalisation too. Some brave spirits now hope, with the old guard moving out, for better. The latest edition of *Southern Weekend*, an official newspaper in Guangdong, published calls for more press freedom. Other publications have carried a daring speech by Li Rui, who was once Mao Zedong's private secretary, saying that “dictatorship is the origin of turmoil” and arguing that democratisation is a prerequisite for China's modernisation. In February, a privately-run think-tank in Beijing organised a symposium on democracy at which several academics said that China should lift its ban on opposition parties and allow freedom of speech. In his summary of the government's “outstanding achievements” of the past few years, Mr Zhu said democracy had been “improved steadily”. A vague phrase, and he didn't spell it out.



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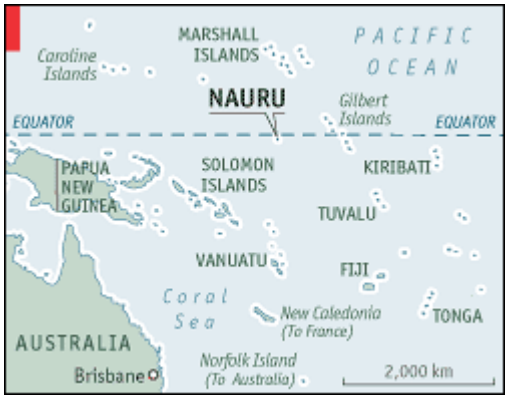
Nauru

Mystery island

Mar 6th 2003
From The Economist print edition

The news from missing Nauru is not good



THE good news is that Nauru, a tiny speck in the middle of the Pacific, is back in touch with the outside world. An Australian engineer has fixed its telephone system, which collapsed in early January. The bad news is that the hazy reports of parliamentary paralysis, riots and fires that emerged during the breakdown all seem to be true.

Things just keep getting worse in one of the world's most dysfunctional countries. For a spell in the 1970s, revenues from phosphate mining gave Nauruans the world's largest income per head. But now there is hardly any phosphate left to mine. In a string of doomed attempts to maintain their standard of living, the islanders have tried everything from money-laundering to bankrolling an appalling London musical about Leonardo da Vinci's love-life. In 2001, the government of the day even agreed to house refugees on Australia's behalf in exchange for a big dollop of cash.

The current chaos stems in part from that decision. Some of the 454 refugees, mainly Iraqis and Afghans, took control of their camp in a riot in late December. The government succumbed to a no-confidence vote soon afterwards. The courts subsequently reinstalled the ousted president, but he quit again a day later, as did the speaker. Amid the confusion, the presidential mansion somehow got burned down. A five-times former president, Bernard Dowiyogo, claimed the office again, but then flew to America for medical treatment. In his absence, the parliament cannot agree on a new speaker, let alone a budget.

The mess rolls on. The government is not paying its employees. It cannot afford fuel to run the island's power plant. It is behind on payments for Air Nauru's one and only aircraft. And if that gets impounded, Nauru will be cut off again.

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Dealing with Iraq

As diplomacy runs out

Mar 6th 2003
From The Economist print edition

Getty

Collision ahead in the Security Council; war ahead in Iraq

Get article background

BY DIPLOMATIC standards, the statement was crystal-clear. On March 5th France, Russia and Germany said they would not “allow the passage of a planned resolution that would authorise the use of force” against Iraq. France and Russia are both veto-wielding permanent members of the UN Security Council, so they could certainly make good their threat, although both pointedly refrained from using the word “veto”.

The trio called on Iraq “to co-operate more actively” with UN weapons inspectors. But America's secretary of state, Colin Powell, argued that time had already run out, and that the world should not be fooled into believing that Iraq's “too-little, too-late gestures” should save it from the “serious consequences” threatened by the Security Council's resolution 1441. That message, delivered two days before the inspectors were due to report to the Security Council on March 7th, was seen as a signal that, so far as America is concerned, the long-threatened shift from diplomacy to warfare is now imminent.

France had earlier proposed that inspectors be given at least another four months. Britain is exploring a compromise to give Saddam Hussein yet another last chance to disarm and a few extra days at most. His recent concessions, such as letting inspectors destroy some proscribed missiles and promising more information on old biological and chemical arms, were dismissed this week by the White House as “the mother of all distractions”.

Barring some new diplomatic gambit, America and Britain say they will press the council to vote next week on their joint resolution with Spain, stating that Iraq “has failed to take the final opportunity” it was given in a council resolution in November to rid itself of all weapons of mass destruction.

With the Security Council so deeply divided, why bother with this vote? America is certain that, legally, it does not need a new resolution, and this week hinted that it might not press for one. Yet a second resolution would help its allies, especially Britain's Tony Blair, who faces a sizeable revolt over military action without one from within his own Labour Party. Failure of the Security Council to act together, it is widely accepted, would also undermine the world body's credibility.

If America and its allies could collect at least the minimum nine votes (out of 15 permanent and rotating members) needed for a resolution to pass, it could increase pressure on France and Russia to abstain, rather than wielding their vetoes. But France has been working just as feverishly to garner enough noes to defeat a resolution without needing to use its veto. Of the six previously uncommitted council members (Germany and Syria say no to force; Bulgaria backs America), this week Cameroon looked

likely to follow the French lead, but the rest—Pakistan, Chile, Mexico, Guinea and Angola—were still being lobbied hard by both sides.

Much hangs on this week's reports from Hans Blix, the chief weapons inspector, and his counterpart, Mohamed ElBaradei, from the UN's nuclear watchdog. Mr Blix was expected to highlight the ongoing destruction of Iraq's al-Samoud 2 missiles, though the inspectors are still awaiting details from Iraq of other potentially illegal missiles, and Mr Powell accuses it of concealing yet others. And although Iraq has handed over more documents, these have so far contained little new to answer outstanding disarmament questions.

Russia wants the inspectors to say how long they will need to address these. Mr Blix has welcomed some signs of co-operation from Iraq, but was saying last week that it had still not made a “fundamental decision” to disarm.

Without that, President George Bush has always said that force will be used, if not with UN backing, then without it. The failure of Turkey's parliament last weekend to endorse a deal the government had struck with America to use Turkish bases—enabling it to open a second front against Iraqi forces, from the north—might delay the start of a military campaign. But then again it might not: America can probably find another way. This week Mr Bush ordered another 60,000 troops to the region, to add to the 250,000 chiefly American and British forces now ready for action.

A “much, much, much” different war

And a war this time, predicted America's senior military man, General Richard Myers, would anyway be “much, much, much” different from the Gulf war in 1991, which relied on many days of bombing and lots of heavy armour. Disarming Iraq, he argued, could best be achieved with a minimum of casualties by delivering a “shock to the system”—earlier reports had spoken of an opening 48-hour barrage of several thousand precision-guided bombs and missiles, with ground troops invading almost simultaneously.

Iraq's neighbours are not counting on French and Russian opposition at the UN to stop a war. An Arab League summit last weekend failed formally to discuss a proposal to give Mr Hussein and senior members of his regime two weeks to quit the country, and ended in a shouting match. Exile is seen by Iraq's increasingly nervous neighbours as probably the only alternative to a war. This week 1,000 Saudi soldiers joined a small Gulf morale-boosting force being assembled in Kuwait, which has run into flak from other Arab governments for letting American troops use its territory to launch their assault on Iraq. The force is only a political gesture but, as even mighty America knows, allies are worth a lot in a tight spot.

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Religion in Iraq

Iraqis turn to God

Mar 6th 2003 | BAGHDAD
From The Economist print edition

And perhaps against each other

Get article background

"I HAVE seen it on the internet: they are killing Iraqis called Omar." Only Sunni Muslims name their sons Omar, so this rumour, articulated in a Baghdad mosque by a furious imam called Sheikh Hisham, is as incendiary as it is unreliable. His argument, echoing that of the regime, is that Iraq's Shia opposition are bloodthirsty Iranian stooges.

As Iraqis pray for salvation, sectarian tensions are mounting. Two-thirds of the population are Shias, but Iraqis have been ruled by Sunnis for centuries. This week saw the start of the rite of Ashoura, when Shias mourn the prophet's grandson, Hussein, and his 72 companions, who were killed at Karbala, south of Baghdad, by a Sunni tyrant, Yazid. The ruling Baath party has long sought to curb the rite's more ardent aspects, such as flagellation and self-mutilation with swords. But some within the regime are calling for it to relax its ban on processions, to soothe Shia grievances, such as those stemming from Saddam Hussein's crushing of a Shia revolt after the last Gulf war.

Mr Hussein may not be convinced, however. With millions bound for Karbala for Ashoura, he has no interest in letting pilgrimages turn into demonstrations, as happened under previous leaders. But he understands the importance of religion. He has rebuilt (sumptuously) most of the Shia shrines destroyed during the revolt, at a cost, says a government guidebook, of "300m dinners". He long ago discovered that he is, by an amazing coincidence, descended from the House of the Prophet, and has engraved his family tree on Karbala's walls. And the man who banned the veil when he went to war with Iran has now put up billboards showing himself and his two sons in a pose suggestive of the Shia trinity.

For the first time, Mr Hussein marked the Muslim new year, which coincides with the start of Ashoura, with a public address. Predictably, he assumed the mantle of defender of the faith, and depicted George Bush as an evil despot bent on destroying Islam. He also reached out to both main Muslim sects. To please Sunnis, he recalled that the Muslim new year marked the prophet's flight from Mecca and the launch of his plans for *jihad* (holy war). For Shias, he made an allusion to Ashoura, appealing to the spirit of sacrifice shown by the earlier Hussein in his resistance to the tyrant Yazid.

To make sure everyone gets the message, Shia clerics on Iraqi television have named America as the modern Yazid. Baghdad's Shia leader, Hussein Sadr, mindful perhaps that several of his relations have met bloody ends, has issued a *fatwa* calling on Iraqis to defend their homeland.

The Iraqi leadership may find comfort in the precedent of 1915, when Shias and Sunnis proclaimed a *jihad* against the invading British. The *jihad* failed, but only after inflicting one of the more serious defeats in British military history. "The threat of foreign conquest is enough to unite Iraq's sects," says a Baath party official. Hikmet, a Shia soldier in Baghdad, concurs. But Iraqis have begun to be afraid of Iraqis. The fury of Sheikh Hisham does not bode well for concord.

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Elections in Iran

A weary country

Mar 6th 2003 | TEHRAN
From The Economist print edition

The reformers gave in to despair

Get article background

“POPULAR disillusionment with the usefulness of the whole regime” was one of President Muhammad Khatami's explanations for the wretched turnout in Iran's local elections on February 28th. The president's reformist supporters lost ground to conservatives almost everywhere. But the real victor was apathy.

Turnout in small towns and rural areas, where voting patterns often reflect family and economic affiliations, was not bad, averaging well over 50%. But in Tehran a risible 12% of the electorate voted, and in no large city did so much as a third go to the polls. This shrugging of the shoulders in the cities worries even the conservatives, who, despite the drubbings they received in past presidential, parliamentary and local elections, could present high voter participation—69% at Mr Khatami's re-election in 2001, for instance—as proof of the regime's underlying solidity. No more.

Reform-minded voters simply stayed at home, which suggests that many have despaired of Mr Khatami's ability to circumvent the conservative institutions that have blocked his attempts to make Iran more democratic. The reformists' star candidate in Tehran was beaten by no fewer than 15 conservatives, and won barely a tenth as many votes as the top-performing reformist in the previous local elections in Tehran four years ago.

The conservatives' victory does not imply genuine popularity: the most popular of Tehran's new councillors was endorsed by a measly 4% of the voters. This is ominous, especially since voters had a much wider choice of candidates than usual. In presidential and parliamentary polls, a conservative watchdog invariably disqualifies liberal and secular candidates. Last week, such people were permitted to stand, but performed dismally.

In Tehran, where the previous municipal council was dissolved amid allegations of corruption and incompetence, the victors are eyeing short-term spoils. They will no doubt alter the currently reformist tone of Iran's biggest daily newspaper, which is owned by the municipality, and redeploy the city's huge revenues from advertising hoardings and the sale of building permits to more conservative ends.

Some see the vote as an endorsement of George Bush's contention that the Islamic Republic has lost popular legitimacy. If that is so, the conservatives, by blocking reforms clearly desired by the majority, are most to blame. This was the point behind Mr Khatami's observation, ostensibly directed at Iraq, that people living under dictatorships might welcome foreign intervention if it means they can “breathe easily”. His pessimism is accentuated by Iran's feeling of helplessness in the face of America's perceived military and political designs on Iraq: designs that, some think, will lead to an American push for regime change in Iran, too.

Mr Khatami will soon have to decide whether to call a referendum designed to give the president more power against the mullahs. Until 2001, he would have romped to victory. In the first couple of years of his presidency, people would have poured on to the streets, if only he had given the word. Now, it seems, a stroll to the polling station is too much to ask.

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Ramshackle Guinea

Ruler and state in precarious health

Mar 6th 2003 | CONAKRY
From The Economist print edition

Guinea, president of the UN Security Council, has a dying president

THE president's foot was not amputated, despite the preliminary medical advice. But, after several small strokes, his circulation remains dire, and though he has hardly been seen since December, most Guineans believe that Lansana Conté, their 69-year-old, chain-smoking, diabetic dictator, is dying.

Awkwardly, this is the month when Guinea is president of the UN Security Council, which makes its potential power vacuum of exceptional concern for outsiders. Will the country vote for or against war with Iraq? Guineans, for the most part, do not care. Few have even heard of Saddam Hussein. Muslim clerics in Conakry boast that theirs is the only Muslim nation to show no interest in the war on terror. On March 3rd, Mamadou Ba, an opposition leader, called for military intervention, not in Iraq, but at home, to avoid chaos.

Most Guineans believe that the army will indeed step in again when Mr Conté expires. Although he was shoved into introducing democracy in 1993, he has done little to encourage it since. In 2001, he rigged a referendum to allow himself to abolish presidential term limits. Officially, the turnout was 93%; unofficially, 15%. Last year, he rigged a parliamentary election—which is easy, since 75% of Guineans are illiterate. Most of the 46 opposition parties boycotted the vote, including the leading Rally for Guinea (RPG), a party whose acronym is more often used in these parts to denote rocket-propelled grenades.

Guinea owes its peacefulness (a recent coup attempt and minor uprising aside) to a strong, centralised army and its rulers' flair for dividing their acolytes and battering dissenters. Mr Conté is less brutal than his predecessor, Ahmed Sékou Touré, who ruled from independence in 1958 until his death in 1984. But by preventing the rise of an able successor, while neutering the new democratic institutions, he has left Guinea in a condition almost as precarious as his own health. The army has no clear leader. A power struggle could set off a conflict between Guinea's (hitherto fairly amicable) three main tribes. And with the region at its most turbulent in years—perhaps a million Guinean migrants are already flooding back from Côte d'Ivoire's war, and Guinean-backed rebels are nearing Monrovia, Liberia's capital—so any new conflict could get out of control.

There is plenty to fight over. Guinea has a third of the world's bauxite reserves, as well as gold, diamonds, iron ore and vast hydroelectric potential. Under Sékou Touré, a Marxist isolationist, these riches were barely touched. Since 1993, with the World Bank's encouragement, some private firms have invested in Guinean mines, but new money has nourished corruption. By one estimate, a fifth of government revenue is pinched, and much of the rest misspent. Most Guineans, already among the world's poorest people, grow still poorer.

Their best hope of avoiding war lies in their extraordinary acquiescence. They seem not yet to have awoken from the proletarian zombiehood of Sékou Touré's time. In recent weeks, Conakry has seen a few mild riots, protesting against power, water, fuel and salary shortages, but the mob always flees at the police's first volley into the air. As for that other fight, against Saddam, Guinea is in a pickle, anxious to offend neither France nor America.

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An African action movie

Beer makes you sexy

Mar 6th 2003 | LAGOS
From The Economist print edition

Africa's answer to James Bond is a feature-length booze commercial

MICHAEL POWER, an unfeasibly hunky African super-hero, strips naked and takes a shower. But as he lathers his muscle-bound torso, the water slows to a trickle, and then stops completely, leaving him in a soapy mess. A rogue politician, it seems, has been diverting funds earmarked for public water projects to buy weapons. Besides spoiling Mr Power's shower, this will deprive millions of clean water. But fear not. Africa's answer to James Bond will expose the conspiracy and restore clean water, and clean governance, to the land.

This, roughly, is the plot of “Critical Assignment”, a new pan-African movie that will be screened in bars and outdoor theatres in 21 countries. The theme is apt: what better quest for an African hero than to fight corruption? Mr Power, a photo-journalist, ducks bullets, flies helicopters, gets the girl and helps bring piped water to impoverished villages. His foes are suitably villainous: a crooked official with a marble-floored mansion, in league, naturally, with a fleshy European arms dealer.

All great fun, but whizz-bang special effects cost money, which African film-makers tend to lack. Nigeria produces a lot of racy, low-budget videos, but rampant piracy and the audience's shallow pockets make big features uneconomic. Unless a multinational pays the bills, as Guinness, a brewer, has for “Critical Assignment”. The film is, in fact, one long beer commercial, short on dialogue and long on product placement.

Guinness's Africa is a bit sanitised. The fictional country where the drama unfolds is a postcard-pretty composite of Nigeria, South Africa, and others. The scenes filmed in Lagos, Nigeria's gritty commercial capital, capture architectural landmarks such as the city's National Theatre, but not the garbage-choked gutters and child beggars. The images shot in South Africa show glistening high-rise buildings, but no shanty towns.

That Nigeria's censors approved a film about corruption shows how much freer the country has become. But not much cleaner: entire neighbourhoods in Lagos regularly run as dry as Mr Power's shower, and the well-off buy water from the fire brigade.

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Turkey

A pivotal nation goes into a spin

Mar 6th 2003
From The Economist print edition

Reuters

Whatever path Turkey's government chooses, it is bound to face howls of protest

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WHEN Turkey's parliament narrowly rejected a government motion on March 1st to let 62,000 American troops on to Turkish soil, a wave of euphoria swept the country, because a good 90% of its people—so say the pollsters—vehemently oppose an American-led war in Iraq. But the joy was short-lived. With dozens of American warships still anchored off Turkey's eastern Mediterranean shores, pressure began mounting on the country's ruling Justice and Development Party to resubmit the bill or risk wrecking relations with the country's most influential friend, the United States. For Turkey's leaders know that, without American co-operation, hopes of rapid economic recovery will recede. And so—just as important, in many Turkish eyes—would Turkey's chance of having a big say in the future of Iraq, its troubling neighbour.

On March 5th, Turkey's top general, Hilmi Ozkok, weighed in on the American side, saying he favoured letting the Americans open a second front against Iraqi forces in Kurdish-controlled northern Iraq, with Turkey as the launch-pad. The odd thing about his statement was that he and his fellow generals had refrained from speaking up earlier. Well, they said, they had not wanted to intimidate parliament.

Many generals, in any event, still doubt the sincerity of the ruling party's recent enthusiasm for a secular Turkey, since its roots are Islamist and the party's leader, Tayyip Erdogan, started his career in a zealously Islamist party. Moreover, not all generals take a pro-American line on Iraq. “Once the Americans come they will never leave,” says Kemal Yavuz, a retired general who is strongly against the war. “We don't know where the military or the government really stands in all of this,” says one weary American diplomat.

So what next? Mr Erdogan is still in a pickle. He faces a by-election on March 9th. Five years ago he was barred by a security court from being an MP and therefore from becoming prime minister, because of a conviction for allegedly seeking to incite religious hatred by a poem he recited in 1997. If he again wins a seat, it is understood that he will be let back into parliament (the constitutional article under which he

was convicted was amended last year) and should become prime minister within a week or so. Hitherto, he has pulled the strings behind the scenes.

But should he, with the generals' blessing, press for a second vote on the bill before his by-election or wait until his premiership is in the bag? He has to weigh several factors. First, would the Americans wait that long? Just as General Ozkok was making his speech, they had begun to divert some of their ships towards the Suez canal, presumably en route to the Gulf. And the Americans have let it be known that they could still open a northern front by airlifting troops into the mainly Kurdish north of Iraq, and would bank on the Kurdish militia operating there for support.

In any event, whatever the timing of a second bill and however hard the generals now urge MPs to pass it, it would still not be sure to get through. Another defeat in parliament would be a huge blow to Mr Erdogan's leadership, whether or not he had become prime minister. It could even cause the government to fall.

Mr Erdogan plainly misjudged the first vote. He had confidently declared that it would be approved just hours before it was rejected. In the event, 264 MPs did vote in favour and 250 were against, but the presence of 19 abstainers meant that the government had failed by three votes to get a simple majority of all those in the chamber at the time.

With friends like these...

Mr Erdogan had underestimated the strength of dissent within his own Justice and Development Party, better known by its initials AK, some 100 of whose members rebelled. Many were from the Kurdish south-east, and were not so much against American troops coming into Turkey as Turkish ones going into northern Iraq.

Bulent Arinc, a mercurial AK man who is parliament's speaker, made no secret of his delight at the government's humiliation. A fiery advocate of lifting the ban on the Islamic-style headscarf in public institutions, he has a lot of support in the party. Barely an hour after General Ozkok's remarks, he said he was still loth to let parliament debate the bill again, and spoke scathingly of “the war lobby”.

Indeed, he noted, predictions that the Turkish lira would collapse as a result of the no vote and thus bring a fresh financial crisis had proved false. And, though Istanbul's stockmarket dived by 10% just after the vote, it soon began to recover; the lira has since held fairly steady against the dollar, thanks to intervention by the central bank. The IMF further boosted confidence when it said it was happy with a new budget unveiled this week.

But the Americans still have means of persuasion. They made it clear that an aid package worth $6 billion which was meant to cushion the financial effects of a war would be shelved, that the Pentagon would no longer approve the idea (mandated by the quashed motion in parliament) of thousands of Turkish troops crossing into northern Iraq, and that Turkey would have virtually no say in shaping Iraq's future. After the no vote, American military engineers who had begun upgrading Turkish ports in preparation for disembarking troops stopped work.

Old pals fall out

It will take a long time for the wounds opened by the American-Turkish row to heal. The Turks think that the Americans have been clod-hopping and insensitive. Even before the vote, haggling over petty issues had become bitter.

And for all of America's repeated assurances that it does not back the idea of an independent Kurdish state, many of Turkey's generals are suspicious. Some Turkish officials suggest that a wave of anti-Turkish demonstrations in northern Iraq have been encouraged by what one has described as “US agents” in the region.

To make matters more awkward between the Americans and the bruised Turkish government, Turkey's generals seem determined—whatever the Americans say—to wade into northern Iraq. According to some Turkish reports, around 20,000 Turkish troops have already crossed the border. The Iraqi Kurds say they will fight back. Turkey's main rival in the region, Iran, will certainly use its own friends in the Kurdish

enclave in northern Iraq to compete for influence.

Nor, despite its spat with America, is Turkey winning plaudits in Europe, particularly since it has failed so far to prod Rauf Denktash, the Turkish-Cypriot leader, into agreeing to a settlement in Cyprus (see article). If, however, Mr Erdogan took the risk, before or after his by-election, of resubmitting the bill to let in American troops, he would take a lot of flak from rebels in his own party and from his compatriots at large. Many Turks would then furiously charge him with trampling on democracy and cowering before bankers, generals and bullying Americans. Mr Erdogan has a rough fortnight ahead of him.

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A settlement for Cyprus

A last, last chance?

Mar 6th 2003 | NICOSIA
From The Economist print edition

The UN's secretary-general offers the islanders a last chance of reunification

Get article background

DEADLINES in Mediterranean countries have a habit of slipping—and so it is proving in Cyprus. After fruitless talks in the divided island's capital, Nicosia, the UN's secretary-general, Kofi Annan, extended until March 10th his ultimatum to the Greek- and Turkish-Cypriot leaders that they should have signed his peace plan's latest version by February 28th.

Mr Annan also changed tack. He proposed that if the leaders were unable to accept the plan, the Greek- and Turkish-Cypriots should themselves give their verdicts in referendums on March 30th. If both communities vote yes, the leaders of a reunited Cyprus would then agree to sign an accession treaty in Athens on April 16th, together with other countries, mainly from central Europe, that are keen to join the EU.

The UN's idea is to stitch Cyprus back together as a pair of two “constituent” states, each of which would run its own affairs, leaving a central government to look after foreign policy and, in particular, relations with Brussels. The second revised plan, say diplomats, was intended to win over Rauf Denktash, the Turkish-Cypriot leader, by letting the Karpas Peninsula, a chunk of territory in the north, stay under Turkish-Cypriot control.

Before the Turkish military intervention in 1974 (after a Greek-Cypriot coup had briefly threatened to unite the whole island with mainland Greece), the peninsula had long been peopled largely by Greek-Cypriots but is considered strategically valuable by Turkey's generals, who have been Mr Denktash's strongest supporters. In return, the Greek-Cypriots would get back some more villages and another stretch of coastline in the east. The overall amount of territory handed back to the Greek-Cypriots under the revised plan would drop just a tad, from 9% to 8% of the whole island. At present the Turkish-Cypriots, who were 18% of the island's population before the invasion, control 37% of its territory.

True to form, Mr Denktash, who has resisted every previous UN blandishment, rejected this one too. But his constituents now overwhelmingly favour a settlement. While Mr Annan was pressing for a deal, about 70,000 people—nearly half the impoverished north's population—showed how they would vote in a referendum by staging a pro-EU demonstration on their side of Nicosia. Thomas Weston, the American special envoy for Cyprus, signalled his country's backing for the UN plan—and its displeasure with Mr Denktash—by turning up among the protesters.

But would the Greek-Cypriots vote in favour too? Even without a settlement, their bit of the island is assured of joining the euro-club, though Günter Verheugen, the EU's commissioner for enlargement, stresses that a reunited Cyprus would have a warmer welcome. But Greek-Cypriot politicians call the latest UN plan “much worse” than previous ones. Without the Karpas prong, they say, Greek-Cypriot hotel-builders have little space for expansion. The British have tried to sweeten the pill by offering to hand over nearly half their sovereign base at Dhekelia, which straddles the present boundary, for settlement largely by Greek-Cypriots; the other base, at Akrotiri, would be untouched.

Tassos Papadopoulos, the new president of the Greek-Cypriot (and internationally recognised) south, used to be a hard man opposed to any sort of compromise with Mr Denktash. Now he says he wants to work for a settlement. Diplomats trying to fix a deal are unconvinced.

The Greek-Cypriots have previously been able to shelter behind Mr Denktash's intransigence. But if, all of a sudden, he is willing to accept a settlement, Mr Papadopoulos might find it hard to rally wavering Greek-Cypriots. Mr Annan says the meeting on March 10th, due to take place in The Hague, would mark a final deadline. There would be no discussion of the plan, just a request for a yes or a no.

After 14 months of negotiation two or three times a week chaired by Alvaro de Soto, the UN's special envoy to Cyprus, Mr Annan says he is calling a halt. If this last effort fails, he says there will be no new UN initiative on Cyprus while he holds the top job. Local pundits guess there is a 50-50 chance of the Greeks saying yes. Otherwise, it will be up to the EU to work out a deal by May 2004, when the new countries are due to enter the expanded club.

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France and Algeria

Partners again

Mar 6th 2003 | PARIS
From The Economist print edition

So says Jacques Chirac, during the first state visit by a French president

Get article background

THE French used to rule the place, and quit in 1962 only after a savage liberation war. Yet Algeria's welcome, both official and popular, for Jacques Chirac, making the first-ever state visit by a French president, could hardly have been warmer. And he knew how to react. Mr Chirac shook hands, kissed cheeks and plunged, regardless of his security men, into the cheering crowds. He also proclaimed before the Algerian parliament “a shared vision of a tolerant Islam” and then signed, with President Abdelaziz Bouteflika, a “declaration of Algiers”, forerunner of a formal treaty to underline the two countries' “special partnership”.

Meaning what, exactly? Was this, Mr Chirac's second trip to Algeria within 15 months (his visit in December 2001 was not deemed “state”), really more than gesture politics? Yes and no.

It is hard, for example, to reconcile Mr Chirac's promise to improve visa procedures—“visa, visa” was one of the crowds' loudest slogans—with the pledge (to the French) of his interior minister to crack down on “the huge increase in the number of visas issued, which is at the root of the growth in illegal immigration”. Thousands of visitors outstay their visas and disappear into the anonymity of the multi-ethnic suburbs that surround most French towns. How many are Algerian no one knows. In 1997, 57,000 visas were issued to Algerian nationals; in 2001, 275,000, thanks in part, maybe, to an easing of the requirement that each visitor give proof of an address in France and means of support. This was still far below the 800,000 a year typical before 1992, when Algeria's present internecine horrors began; and the total slumped last year to 183,000. But that hardly reassures French voters.

Yet behind the Chirac rhetoric lies serious politics, domestic and international. Some 5m Muslims live in France. Of these, 537,000 in 2001 were lawfully resident Algerian nationals. Add French citizens of Algerian origin and the total is large enough to be a permanent issue in French politics. The extreme right trades in xenophobia. Arab youths complain of rampant discrimination (a 1992 study found 40% unemployment among French youths of Algerian origin, as against 11% among those of French origin). Foreign imams in French mosques spread the message of an extremist Islam—and the security services note the North African, especially Algerian, influence in Europe's terrorist groups.

Hence Mr Chirac's care to list Islam, “the second religion of France”, among the two countries' links. And when he spoke of a tolerant Islam, everyone knew what he did not mean: the extremists whose terrorism (and the repression thereof) has cost Algeria maybe 150,000 lives. France's views on Palestine and Iraq are also such as to win Algerian friends.

Yet what will it all add up to? France rides high in Arab opinion. But reality could be sobering. The two countries' new “partnership” echoes the EU's “Barcelona process”, begun in 1995 with the aim of enriching all countries on the Mediterranean. Those to its south are not rich yet.

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Germany's labour reforms

How far dare the chancellor go?

Mar 6th 2003 | BERLIN
From The Economist print edition

The unions are angry. Gerhard Schröder may make them angrier yet

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THE long-ailing Alliance for Jobs, a forum of trade unions, employers and government, is dead at last—and with it Chancellor Gerhard Schröder's hopes of consensus for his supposedly radical package of labour-market and welfare reforms.

The package is to be revealed to the Bundestag, the lower house of parliament, on March 14th. When he chaired a meeting of the alliance on March 3rd, the chancellor called for "talks without taboos". But no one was ready for compromise, and the union leaders, who see almost any reform in these fields as an attack on themselves, stalked out, declaring that they would not accept a "dismantling of the welfare state".

They are especially angry that Mr Schröder plans to relax Germany's strict job-protection rules, despite his campaign pledge last year not to do so. At present, any worker in a company with more than five employees is protected. So micro-employers hesitate to hire extra workers because they won't be able to fire anyone when business turns down. Wolfgang Clement, the superminister for economics and employment, is proposing a more flexible system: only the longest-serving employee, not all five, would get protection when a sixth worker was taken on, the next-longest-serving when a seventh one was hired, and so on, up to an as yet undecided limit. In larger companies, Mr Clement wants those laid off to have to choose: they can have a fixed level of compensation (which is not now automatic) or go to a tribunal to protect their jobs but abandon all right to financial compensation.

Mr Clement does not pretend his proposals would create many jobs. But he sees the issue as a "highly symbolic" test of the government's ability to push through taboo-breaking reforms. The unions too see it as a test—of the government's ability to break their power. "We're not talking about peanuts," one union leader said: "This is all about crushing our influence."

It is. Though the DGB, the giant union confederation, and its eight member unions by now represent only one worker in five, their power is still great. They sit on company supervisory boards and works councils. With the employers, they run the state's welfare-insurance schemes (health, unemployment, pensions). They sit on the labour tribunals. And—whatever government is in power—their advice is sought on a whole range of policy issues, from taxes and immigration to genetic engineering and local-government finance.

This is all part of Germany's post-1945 tradition of consensus politics. But many are beginning to question the system. It has brought industrial peace but it also blocks radical reform. Christian Democrat leaders want the unions' influence cut back; Guido Westerwelle, leader of the free-market Free Democrats, Germany's liberals, has called the unions "the grave-diggers of the welfare state" and "a plague on our country". He believes it is time for a Thatcherite confrontation.

Union membership has fallen by more than a third over the past decade and is still falling

Mr Schröder—a union member, like Mr Clement and three-quarters of his Social Democratic backbenchers—jumped to defend the unions, condemning attacks on "a well-tried system that has made our country strong". But he plans to press on with reform. His forthcoming state-of-the-nation speech to parliament will provoke "cries and gnashing of teeth", he says. It will be carefully scrutinised to see just how just how far he is ready to go in confronting the unions and his own left wing.

He plans to sweeten the pill with news of a huge public-investment programme. But it will still be hard

for the unions to swallow. It is expected to include: less job protection; lower long-term unemployment benefits; big cuts in official job-creation and training schemes; an extension of the low-wage sector; a review of the “co-determination” rules that give workers a say in management; more flexible wage bargaining; abolition of the “master” qualification for self-employed craftsmen; longer shop-opening hours; obligatory private insurance for certain health services (eg, false teeth and sporting accidents) now covered by the public system; and the introduction of a basic charge for each visit to the doctor.

In many ways, the time is ripe for pushing through such unpalatable reforms. The unions are under pressure. Their membership has fallen by more than a third over the past decade and is still falling. The economy is stagnant and, on unadjusted figures, 4.7m Germans, more than 11% of the workforce, are out of work. The generous welfare system is near financial collapse. Even the toughest union leaders realise that something has to give.

Battered in two state elections in January, the Social Democrats suffered again in local ones in Schleswig-Holstein on March 1st and 2nd. But Mr Schröder has a “window for reform” before the next big wave of state elections late next year. His opposition to any war in Iraq has helped rally his party around him. His backbenchers on the left may rage against his government's “neo-liberal experiments”, but they are loth to bring it down. Now is the time for him to act—if he has the guts.

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A new Czech president

Prickly Vaclav Klaus

Mar 6th 2003 | PRAGUE
From The Economist print edition

Czech MPs choose a very different sort of president from the last one

THE election of Vaclav Klaus as the Czech president won't raise American hopes for a pliant “new Europe”. Where his predecessor, Vaclav Havel, was cuddly and accommodating, Mr Klaus, aged 61, will be prickly and adversarial. During his five-year spell as prime minister (first of Czechoslovakia, then of the Czech Republic after it split off) he declared himself a Thatcherite. Populist nationalist may be nearer the mark.

These days he is against a war in Iraq and calls Mr Havel misguided for backing the Americans. He will also be a thorn in the side of Brussels. He admits that Czech entry into the European Union is inevitable but bemoans the terms of entry. He dislikes Franco-German collusion and loathes what he sees as European federalism. He fears that the European constitution, now in the making, will be a vehicle for dodgy ideas.

Most Czechs are still astonished that Mr Klaus was elected at all. He probably would not have been, if they had been given a say. A quarter of his countrymen adore him but he annoys most of the rest. His free-market Civic Democrats lost last year's general election; his party got only 25% of the vote to the Social Democrats' 30%. After his defeat, Mr Klaus was hospitalised for “disorientation”. Few thought he would make a comeback, let alone grab the presidency.

Fortunately for him, the Czechs' system for finding a president came to his rescue. The Czech head of state is elected by secret ballot in the two houses of parliament. In the first round, in January, he took a slim lead in a much-divided lower house but trailed badly in the upper house. After several inconclusive results, he squeezed in this week by a single vote. His victory, a testament to feuds among his opponents, highlights the weakness of the Social Democrats' prime minister, Vladimir Spidla, whose party's own MPs back-stabbed each other throughout the process.

Mr Spidla now faces a vote of confidence. Mr Klaus has almost no executive power as president but can wheel and deal behind the scenes—and will certainly try to get the Social Democrats, who run a minority coalition government in partnership with a group led by Christian Democrats, out of government. But how?

Mr Klaus paid a heavy price for his election. Though he has long railed against the reviving Communists, who got 19% of the votes in last year's general election, he owes his presidency to a deal with them. Some may be drawn to his strongman style and nationalist language. Mr Klaus says he promised them nothing more than simple recognition. So his Civic Democrats are very unlikely to team up with them, while the parliamentary group led by the Christian Democrats is barely keener to gang up with Mr Klaus's lot. So expect a period of political turbulence.

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Poland's minority government

Soldiering on

Mar 6th 2003 | WARSAW
From The Economist print edition

Poland's embattled prime minister has a fair chance of survival

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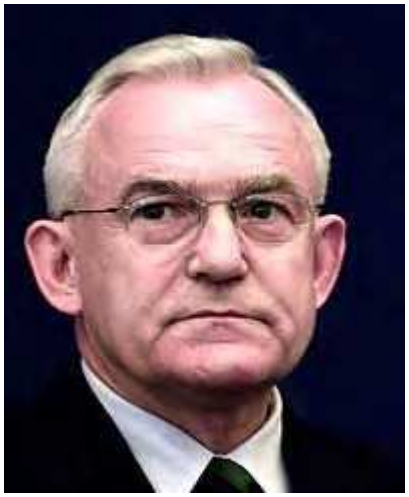
Reuters



Miller gets divorced

“I WILL be no one's hostage,” promised a glum Leszek Miller, Poland's prime minister, after expelling his junior coalition partner, the Peasants' Party, from government on February 28th. The troublesome alliance between Mr Miller's europhile (albeit ex-communist) Democratic Left and the parochial Peasants collapsed after 16 months when the farmers teamed up with the opposition in parliament to vote against the government's flagship infrastructure bill.

This rebuff, coupled with the Peasants' wishy-washy support for Polish membership of the European Union, was enough to force Mr Miller's hand. But his government has a fair chance of survival, at least for a while, even with a minority of seats in parliament. And, no less vital for Mr Miller, he should still be able to win a referendum in June to let Poland join the EU next year.

While Poland's constitution shields a minority administration in the absence of a viable alternative, the government will have to scour the lower house for ad-hoc allies to pass its legislation. A plan unveiled last week by the finance minister, Grzegorz Kolodko, to streamline the public sector in preparation for EU entry will be tortuously hard to approve. If it falls by the wayside, the government might then be doomed.

But the outcome of the referendum in June is its biggest worry. Though the Peasants' leader, Jaroslaw Kalinowski, flew with Mr Miller and his team to Copenhagen last December to negotiate final details of Poland's entry into the EU, the party itself is reluctant to endorse a yes vote in the referendum before gaining cast-iron guarantees from the government for propping up farmers' incomes. Already eclipsed by its militant agrarian rival, Samoobrona (Self-Defence), the Peasants may split, with their radical wing throwing in its lot with Poland's anti-EU camp. That could give a big boost to the no campaign. Euro-tuned Polish nerves may start to jangle.

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Charlemagne

Philadelphia or Frankfurt?

Mar 6th 2003
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Grandiose hopes for the convention on Europe's future may get punctured

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NO MEETING of the European Union's constitutional convention in Brussels is complete without a reference to “Philadelphia”. Valéry Giscard d'Estaing, the convention's president, has often compared the work of the Brussels delegates to the labours of the founding fathers who wrote the American constitution. Each time the conventioneers set to work you can feel them mentally posing for their portraits, quill pens in hand. Yet Europe's history is littered with discarded constitutions and failed conventions. Perhaps Brussels 2003 will one day rank alongside Philadelphia 1787. But who is to say it will not instead end up like Frankfurt 1848, a gathering of high-minded people intent on writing a constitution for a new nation (Germany), whose efforts were swept aside by history. Bismarck, the man who succeeded in unifying Germany, made his famously brutal comment about the decisiveness of “iron and blood” in international affairs as a rebuke to the Frankfurt conventioneers who had put their faith in “fine speeches and the votes of majorities”.

As the Iraq crisis gathers pace, the whiff of blood and iron in the air is already unsettling the conventioneers in Brussels. William Abitbol, a French right-winger, told the delegates last week that their deliberations were increasingly “surreal” against unfolding international events. More senior figures in the convention—the foreign ministers of Germany and France, for instance, and Mr Giscard d'Estaing himself—made guarded references to the growing possibility that the EU's disarray over Iraq could gravely undermine the convention. Its secretariat had been planning to use the most recent session, at the end of last month, to publish some draft articles on a common EU foreign policy but decided to delay unveiling them for fear of ridicule. They now hope for a foreign-policy debate in May.

But it is not just unexpected events in the world that can derail constitutional conventions. There is also a chance that delegates will simply fail to agree—or fail to sell an agreed proposal to the public. In present circumstances, both risks are fairly high.

The Philadelphia affair was more compact: a mere 55 delegates deliberated more or less continually for four months. The 105 delegates to the Brussels convention have been meeting intermittently for over a year and still have several months to run. Indeed, the real number of participants is over 200, since alternates have virtually the same rights as full members. When Mr Giscard d'Estaing and his 12-strong presidium issued the first 16 articles of a draft constitution last month, they were deluged with over 1,000 proposed amendments from all sides; integrationist Germany has tabled almost as many amendments as the sovereignty-minded British.

Unexpected alliances are emerging. For example, the British and Germans have both objected to the idea of giving the Union “exclusive competence” (ie, sole power) over the internal market's “four freedoms”, which include human movement. They fear this might end individual countries' control over their frontiers; some of Mr Giscard d'Estaing's closest aides agree that this article will have to be changed. To take another example, the British, French and Germans have ganged up against the idea that the EU should co-ordinate all EU countries' economic policies. A fair number of delegates are demanding an explicit mention of religious values. And no fewer than 28 have objected to indulging one of Mr Giscard d'Estaing's own passions by including space exploration as an EU objective. All these complaints have been registered before Mr Giscard d'Estaing's team has even unveiled its proposals for two of the most controversial topics facing the convention: foreign policy and the distribution of power between the various bits of the EU's governing structure.

If Mr Giscard d'Estaing is to present a single constitutional proposal, as he wants to, he will have to be

both ruthless and lucky. He has already shown a marvellous ability to discern consensus where others see only discord. He argues, for example, that those who object to the use of the word “federal” in the proposed constitution's first article are noisy but only a minority. Maybe. But it is a minority that includes the representatives of ten of the convention's 25 participating governments. Mr Giscard d'Estaing's real aim is to meet the most strident objections of all those governments (which must, after all, sign the document), while ignoring the cacophony of other dissenting voices.

Another giant pair of obstacles

Getting the conventioneers to agree to just one document will still be very tricky. But even if Mr Giscard d'Estaing pulls it off, another two big hurdles stand in the way. First, he must secure the agreement of all 25 governments (including those due to join next year) which will meet at a special conference to consider his work. He hopes that his convention will have built up such a head of steam, especially since so many top government figures will have taken part in its deliberations, that all those governments will approve the new treaty without trying to unpick it. Maybe. On the other hand, the range of opinions in the EU is so wide that many governments are bound to object to bits of the constitution. Will they really forgo a last chance to tweak it? To do so would need huge goodwill on all sides. But the Iraq crisis may leave a legacy of bitterness between different European leaders that could spill over into the constitutional negotiations.

Even if governments do unite around Mr Giscard d'Estaing's proposals, the final hurdle is winning popular assent. Several governments, notably the Irish and Danish ones, are obliged to hold referendums on constitutional matters. Others, notably the French, say they intend to have one too. History suggests that plans for tighter European integration stand a good chance of being rejected if people are actually asked their opinion. If several countries—or even a single big one, such as France—turn down the treaty, Mr Giscard d'Estaing's constitution could yet end up in the rubbish bin rather than the history books.

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The newspaper industry

Fading

Mar 6th 2003
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Things look pretty bad in the newspaper business. They are worse than that

THE British newspaper industry thinks rather highly of itself. It sustains 11 national titles, and unusually high readership levels. It has a culture of irreverence, from which it looks down at the tame and stodgy German papers, and now at *Le Monde*, France's leading high-brow newspaper, recently the target of accusations of political collusion. Yet British newspapers are in bad trouble—even worse than meets the eye.

At first glance, things look gloomy enough. Pearson, part owner of *The Economist*, reported this week that its flagship title, the *Financial Times*, lost money in the second half of 2002, and just scraped a £1m ($1.6m) full-year operating profit, 92% down on 2001. Operating profit at Rupert Murdoch's British papers, the *Sun*, the *Times* and the *Sunday Times*, fell 37% in the last quarter of 2002 compared with the same period of 2001. Circulation revenues at the *Sun* have been battered by its price war with the *Mirror*. Journalists are being fired; pay packets and expense accounts frozen; pension schemes slimmed.

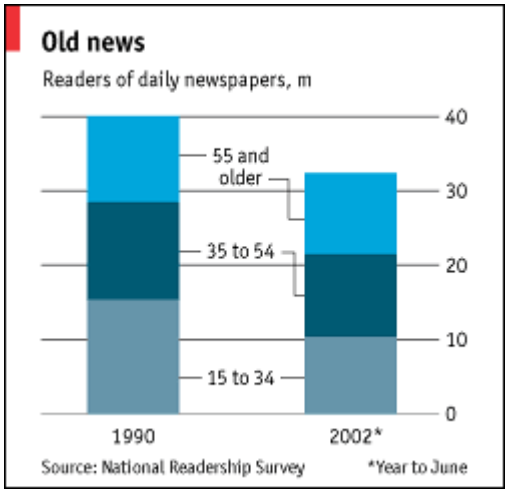
One reason is the advertising slump. Following a bumper year in 2000, when advertising revenues across the British newspaper industry soared by 12%, they dropped by 2% in 2001 and a further 3% in 2002. Those figures disguise huge variation across the industry. While some businesses, such as fashion, are still advertising heavily, others, such as technology, telecoms and financial services, are not. Advertising revenues at the *Financial Times* fell by 23% in 2002, after a 20% decline in 2001.

Newspapers are losing readers too. In the second half of 2002, circulation fell from the same period of 2001 at all but three of the national titles, and at every one of the broadsheet newspapers. Even the *Daily Mail*, middle England's favourite, is now losing readers for the first time in ten years.

Behind these dismal figures, however, things look even worse. Overall national newspaper readership has dropped by a fifth since 1990, according to the National Readership Survey (NRS). Sensing the trend, advertisers are shifting to other media to get their messages across. The share of all advertising spending taken by newspapers shrank from 21% in 1985 to 19% in 2001, according to Mediaedge:cia, a media-buying agency, while radio's share grew from 2% to 5%, and billboards' from 5% to 7%.

Most troubling of all for the industry, young people are just not buying newspapers the way their parents did. The number of newspaper readers under the age of 24 has shrunk by over a third

since 1990, while those over 65 has fallen by only 6% (see chart). The *Daily Telegraph* boasts the greyest newspaper readers, 29% of whom are now over the age of 65. But the share of older readers is growing faster at other papers, including the *Independent*, the *Times* and the *Mirror*.



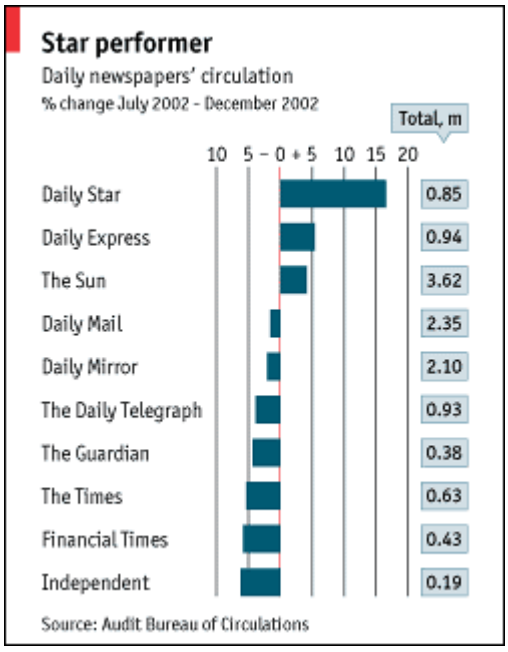
Young Britons are getting their news either online, or from television or radio, and by "news-grazing" in snatches through the day, rather than sitting down for a good read. Partly thanks to the proliferation of independent radio stations, combined with the extra time spent sitting in traffic jams, radio listenership has risen by a quarter in the past five years. A survey last year by Freeserve showed that, in the 50% of homes that are wired to the internet, online news sites beat newspapers as the main source of news, and were topped only by TV and radio. "Newspapers are not now usually the first place that young people get their news," says Roger Pratt, head of the NRS. The worrying implication is that the industry is simply not nurturing its future readers. This generation is growing up with no particular brand loyalty to any newspaper, nor any entrenched habit of reading daily over the breakfast table.

When young Britons do read newspapers, they tend to like the ones without much news. Richard Desmond, the owner of Express Newspapers and publisher of titles ranging from *Women on Top* to the *Daily Star*, has reinvented this end of the market. Of the three daily tabloids that bucked the circulation decline in the second half of 2002, two (the *Express* and the *Star*) were his; the other was the *Sun*. Circulation at the *Star*—typical headline: "Kylie's bum is so yum"—shot up 17%.

To the dismay of his high-minded rivals, Mr Desmond has invented a new low-cost business model for the, er, bottom end of the tabloid market. News-gathering is costly, so his papers mostly dispense with it: he got rid of nearly a third of editorial staff in the six months after he bought the Express group. Instead, they rely heavily on celebrity "news", often jointly with *OK!*, a specialist weekly.

What can newspapers do to survive in this contracting market? One option is to compete on price; but, as a tussle on this front between the *Sun* and the *Mirror* shows, it risks simply bleeding revenues.

A second strategy, to shift to a new market position, has proved hard to pull off. While the *Sun*, under its new editor, Rebekah Wade, is trying to recapture younger readers with mischief and oomph, the *Mirror*'s worthy effort to desert the celebrity game and go upmarket—it typically squeezes celebrity news into only half the front page, leaving the rest for war—has not been rewarded. It is now hunting readers in the overcrowded middle ground, where the line between broadsheet and tabloid is blurring. At times, the news judgment of the *Daily Mail* (asylum fears, health scares) is all but indistinguishable from that of the *Times* (asylum fears, health scares).



A third idea is to launch new titles. This can work, even in the current gloom. *Metro*, a freesheet launched in 1999 by Associated Newspapers, publisher of the *Daily Mail* and the *Evening Standard*, has just started to make a profit. Mr Desmond is threatening to start his own free London rival to the *Standard*. Associated may retaliate by introducing a rival to the *Star*.

But as too many papers chase fewer and fewer readers something will have to give. Simon Mays-Smith, a media analyst at J.P. Morgan, says: "Nearly a dozen newspapers in the UK, given the decline in circulation, just isn't sustainable."

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University admissions

Dumb tests

Mar 6th 2003
From The Economist print edition

Britain's universities face howls of protest whatever they do

Get article background

CHARMING children with straight As who have been turned down by Bristol University now appear with monotonous regularity on the front pages of British newspapers. That is because Bristol has enthusiastically taken up the government's campaign to get more state-school pupils into university; it is therefore accused of turning away private-school pupils with impeccable grades in favour of poor children with worse ones. Now it faces a boycott from the private schools that provide 40% of its students.

Any admissions system is bound to be contentious. At stake is a scarce good, widely (if wrongly) regarded as determining future happiness and earnings. That puts two powerful forces at odds. Parents who have spent £10,000 ($16,000) per child per year to educate their children feel cheated if the system is being tweaked against them. The government thinks it is wrong that a state-funded system benefits rich people disproportionately.

The main means of selecting students, A-levels—always flawed—has become less useful. The marking system is plagued by scandal. Grade inflation means that too many candidates get straight As.

Private-school pupils do much better than state-school pupils—startlingly so in difficult subjects, such as science. They make up 8% of schoolchildren, and get more than half the A grades in physics. This may be because they are cleverer—with brains expensively nurtured for 14 years it would not be surprising—or because they have been crammed to pass A-levels, or both.

Either way, on March 5th, Charles Clarke, the education secretary, said that in future universities will have to use a wider range of indicators. At present not many are available. Application forms include a school reference (of limited use unless both sides know each other well); and a statement from the candidate (independent schools are very good at coaching their pupils how to fill these in).

So more information would be good. One possibility is American-style Scholastic Aptitude Tests (SATs), wide-ranging tests, not based on a syllabus, which some British educationalists describe as “11+ for 18-year-olds”. Peter Lampl, who runs The Sutton Trust, a charity that tries to help poor children get into good universities, favours SATs. He says they are quick, cheap to mark and differentiate children more widely and precisely than A-levels.

But a good school can probably coach students to pass them. Graham Able, headmaster of Dulwich College, says that his applicants to Harvard had both straight As at A-level and the maximum possible SAT scores. What's more, SATs are controversial in America because blacks do badly in them. That is one reason why advanced placement tests, which are subject-based—and therefore, ironically, more like A-levels—are increasingly popular in America. In the 1960s, a study was carried out to determine whether SATs, A-levels or O-levels (tougher forerunners of the GCSE exams now taken at 16) were the best predictor of university applicants' performance. O-levels were best, it turned out, because it is harder to cram students for a wide range of subjects.

Interviews are out of fashion, supposedly because they are unscientific. (They are also expensive and time-consuming, which may be another reason why admissions tutors are glad to dispense with them.) But they may come back. So may separate exams. Oxford and Cambridge had these but dropped them, on the grounds that state schools couldn't prepare their applicants properly. But the switch to assessment by A-level only has made things worse, as state-school applicants lost a way of showing they could shine. Top universities, singly or together, may start developing tests of their own.

Collecting more information about students by any of these means is expensive, but makes it likelier that universities will get the right people. The worst fix is to use crude quotas, equating private education with privilege. Nobody should know this better than Tony Blair, whose own son, educated at a (very exclusive) state school, is currently at, er, Bristol.

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Anti-war students

Dream on

Mar 6th 2003
From The Economist print edition

Students think their protests will stop the war. Tremble, Tony

REMEMBER student revolutionaries? They're back. In universities across the country, bright-eyed young people are planning marches and acts of civil disobedience that (they hope) will bring the attack on Iraq to a shuddering halt.

For years, the student rebels have lacked a cause. The anti-globalisation movement, so promising at the time of the 1999 Seattle demonstrations, fell apart, a victim of its own incoherence. Activists honed their media skills in the interminable campaign against top-up fees, but kept being outfoxed by politicians who portrayed them as middle-class whiners.

The anti-war movement initially seemed to be going the same way, after the war in Afghanistan failed to rouse popular opinion (and then proved disappointingly short and undisastrous). But last month's protest march in London, which huge numbers of students took part in, changed everything.

Campus anti-war groups have since sprouted almost everywhere. Students are now drawing up plans for the outbreak of war on 'Day X'. A typical plot, hatched by activists at University College London, features a 5pm rally and march to Trafalgar Square, timed to coincide with similar actions at three nearby universities. Simultaneously, the students' union will call a two-day lecture boycott. Academics will be encouraged to cancel classes or turn them into protest meetings rather than lecture to empty seats.

It is a long way from sit-ins to regime change in Downing Street. Even if the Day X activities work as planned, the resulting chaos will be only a faint echo of the student movement in the late 1960s and early 1970s, when such protests closed down universities for weeks at a time. And today's student rebels are a different breed from their baby-boom forebears. As Rodney Barker, professor of government at the London School of Economics, explains, students used to see themselves as intellectual warriors fighting on behalf of oppressed people everywhere. Now they are just concerned citizens, albeit ones with lots of time and energy.

But this ideological dilution helps to explain the broad appeal of the anti-war campaign. That students at London's top universities are planning marches is hardly surprising: they are heirs to a radical tradition. Yet protest groups have also emerged at vocationally oriented institutions like Leeds Metropolitan University, where students traditionally have had a hard-nosed attitude that education is a tool for career advancement. Large Muslim populations in such places may have helped sway the student body against war.

The student anti-war movement may yet fizzle out. But there are a couple of reasons to think otherwise. First, student protesters are backed by faculty and parents. For a group that is not always as independent-minded as it likes to think, this is a key advantage—and a big change from the grown-ups' attitudes to most past protests. Secondly, the slow build-up to war has given the protesters ample time to prepare. As a Manchester University organiser explains, "Time is on our side. Every day the war doesn't start is a good day for us."

Unless, of course, the Easter holidays come first.

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Psychology

Mind how you go

Mar 6th 2003
From The Economist print edition

Trauma counselling can be bad for you, yet some firms make it mandatory

WAR in Iraq may bring death and destruction—but one feature of most civilian disasters, stress counsellors, will be commendably absent. Soldiers and psychologists, gathered together in London on March 5th to discuss the effects of war on participants' psyches, agreed that post-traumatic stress disorder (PTSD) counselling, which is common, and sometimes compulsory, after disasters, can do more harm than good.

These modern ambulance-chasers roll up after bank robberies, car and train crashes, terrorist attacks, wars, anything involving casualties. Companies call them in for fear of lawsuits or because, these days, their insurance companies may require it.

Brain researchers think that the human mind recovers naturally from psychological traumas by replaying events, and constructing new memories. Only those whose symptoms persist after many months have PTSD and need treatment. Thus, says Simon Wessely, a professor at the Institute of Psychiatry at Kings' College, London, it is pointless to give psychological debriefing to, say, everyone involved in the Paddington rail crash when they have nothing, except their journey, in common. Worse, unnecessary counselling may increase the likelihood of PSTD in some cases by making people fear that they may be mentally ill.

Lieutenant-commander Neil Greenberg, a Royal Navy psychiatrist researching Gulf war illnesses at Kings' College Hospital, says mass counselling is particularly unhelpful in the military. Wading in after an event with the “goatee beards and inflatable couches”, he says, does not work with the military mind, and can make things worse. Military training gives a much better psychological preparation for war than any amount of counselling, which, he says, tries to create victims.

Mr Wessely, who advises the British army, agrees. After the Gulf war, 3% of soldiers had PTSD—compared with a background rate of about 1%. But 97% of soldiers did not develop the disorder, despite going through traumatic situations. Some soldiers described the war as the “best time of their life”. That may change this time, especially if soldiers face a real threat of biological or chemical weapons.

Not everyone is lucky enough to have good training, a stiff upper lip and strong friendships. Fully 5% of civilians involved in earthquakes and floods are likely to develop PTSD, and 20% of those in fatal car crashes. The highest degree of civilian trauma comes from rape. Most rape victims get PTSD, and after six months 50% will still have it.

But the ailment is now fashionable enough to attract the interest of those with mildly upset feelings. In lower Manhattan, says Mr Wessely, 40% of the population believes it has suffered PTSD since September 11th. Yet work by American psychologists among those who underwent counselling also suggests that many would have been better off without it. And a study in Israel of heart-attack victims showed that while 7% of those who buttoned up developed PTSD, 19% of those who spilled out their feelings did. Repression, as the British always knew, works. And it's a lot cheaper, too.

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Northern Ireland

Farewell to arms

Mar 6th 2003
From The Economist print edition

The peace process is up and running again, but success depends on the IRA

Reuters

Bertie Ahern and Tony Blair get it together at Hillsborough

Get article background

THIS week, Tony Blair took a couple of days off from trying to disarm Saddam Hussein, and spent 30 hours holed up in Northern Ireland's Hillsborough Castle looking for a way to persuade the IRA to give up its weapons. While the IRA has never aspired to the kind of stuff Mr Hussein likes, its reluctance to give up its weaponry has bedevilled the peace process throughout the five-year existence of the Good Friday agreement.

Mr Blair, with his opposite number from the Irish Republic, Bertie Ahern, was making a determined effort to present Northern Ireland's feuding political parties with a new deal that would open the way for the IRA to do the two things that both Unionists and the British government say are essential if devolved government is to be restored to the province—to make a statement that in effect declares the war to be over and to move rapidly to destroy its remaining stock of weapons. According to intelligence estimates, about 1,700 guns and three tonnes of explosives and heavy weaponry lie in secret bunkers. This “act of completion”, Unionists insist, must be transparent and verifiable.

Although the IRA's guns have been more or less silent since the 1997 ceasefire, it is difficult to overstate how hard it finds it to make the final break with its violent past, especially under pressure from its old enemies. But Mr Blair and Mr Ahern believe that the leaders of Sinn Fein, Gerry Adams and Martin McGuinness, now accept that without such an “act of completion”, the power-sharing assembly at Stormont that was suspended last year after various IRA shenanigans will stay closed. Giving added urgency to the negotiations are fresh assembly elections, scheduled for early May, but now postponed until the end of that month.

The exact contents of the 28-page blueprint for a settlement that the two prime ministers brought to Hillsborough will not be known until the publication of a final document next month. But its outlines are clear enough, as are the areas where agreement is proving difficult.

During the talks, which were the most intensive since the Good Friday agreement, progress was made on previously contentious issues, such as policing and what republicans call “demilitarisation”—the

withdrawal of the few British troops still in Northern Ireland and dismantling of surveillance systems.

Apart from the things the IRA must do, at least one big issue remains. The Unionists are demanding an international body to monitor ceasefires and impose sanctions on politicians linked with those who break them. Sinn Fein, which has got into trouble once for IRA violations, sees this as a way to exclude it in the future. But having got so much that they have wanted for so long, it would be surprising if Messrs Adams and McGuinness didn't come up with something. The only question is whether it will be enough.

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The tube's Central Line

Mind the gap

Mar 6th 2003
From The Economist print edition

Why a small accident has caused such large problems

Get article background

ON JANUARY 25th, an electric motor fell off the bottom of a train on London's Central Line, busting the safety bracket that was designed to catch it. It dragged along the track. Eventually some carriages came off the rails. Everyone was evacuated safely, with one minor injury.

Since then, the Central Line, one of the most important parts of London's underground railway, has been out of action, spoiling millions of journeys. In perhaps two weeks, says Mike Strzelecki, a director of London Transport, there will be a shuttle service operating between stations at the eastern end of the line. Return to full service will take up to two months.

Why? Because London Transport decided to replace the bolts and brackets on all 85 trains on the Central Line. That means taking each train to pieces, and checking the motor, the gearbox and the coupling between them (something involving that coupling is suspected as the most likely cause of the derailment). Then engineers can put the new bits on. They started on March 1st and are doing 1.8 trains a day. This may rise, but to no more than three a day because there is no room in the depots.

Things would be much simpler if the accident had happened on a modern metro, on which all the trains are the same. In London's ramshackle system, the Central Line uses special trains, designed for its narrow tunnels and tight corners. They are “a bit of a nightmare” says Mr Strzelecki, with feeling. Their bad design reflects the poor management and penny-pinching that has plagued the tube for half a century. Maintenance is tricky: simply inspecting the bolts that hold the motors and brackets is a hard, neck-craning exercise.

But the way the railway is run is clearly part of the problem too. The clearest example is from the Waterloo and City line, a short branch line that, uniquely, uses the same kind of trains as the Central Line. These carriages were put back into service soon after the accident, with supposedly better bolts—eight of which then proved not to have been tightened at all. The workers concerned, it seems, stopped for a snack and never completed the job.

As a result, the management, determined not to be accused of carelessness, has hired a team of aircraft engineers to check every bit of work on the Central Line trains independently. That slows things down, and keeps costs up—Mr Strzelecki reckons the accident and its aftermath may cost up to £25m. The new bolts must be inspected daily, at least initially, to make sure they are still tight.

Inquiries are under way to find out what really caused the derailment. That may mean further costly changes.

But the bigger question is about safety, actual and perceived. London's underground is, by common consent, clapped-out, cramped, smelly and dirty. There are big shortcomings in both workforce and management (the latter, according to Ken Livingstone, London's mayor, are “knuckleheads”). It is facing a fiendishly complicated semi-privatisation.

But it is not dangerous. “People make a lot of noise about an incident in which nobody was seriously injured,” says Mr Strzelecki. “There is not a railway in the world that does not have derailments.” So was closing it down, in effect indefinitely, to replace every bolt and bracket on every train, perhaps an overreaction? An outsider might think so. Many London commuters might have preferred a tiny extra risk to weeks of discomfort and delay. Those that have taken to bikes and scooters during the line's closure

are making just that choice. But what railwayman would be brave enough to say that in today's safety-mad world?

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Health service reform

Reinventing hospitals

Mar 6th 2003
From The Economist print edition

The plan to free hospitals from central control will not cure the NHS

FIRST it caused a vicious dispute between top ministers. Now it could instigate a big revolt of backbenchers. The plan to free some top-performing hospitals from central control presses all the wrong buttons for many Labour MPs. But despite the political fireworks, the reform will not transform the NHS.

Foundation hospitals are Labour's big new idea for health reform. Backed by Tony Blair, the plan is to set NHS hospitals free from detailed central control. The prime minister believes that this will unleash local energies that are currently suppressed by excessive central supervision.

Treating NHS patients will be the overriding priority for foundation hospitals. They will have to meet demanding national standards and will be overseen by a new regulator. Within this framework, however, they will answer to a board of governors, most of whom will be local people elected by patients. Initially there will be only a dozen drawn from the 32 three-star hospitals that have applied. But the intention is that more will join this vanguard, so that foundation status becomes the norm rather than the exception.

Tony Blair may like foundation hospitals but Gordon Brown does not. The chancellor of the exchequer went into battle last year with Alan Milburn, the health secretary, to restrict the financial freedoms that foundation status would bestow. Mr Milburn wanted the new hospitals to be able to borrow from the private sector. Mr Brown insisted that the money would have to count against existing public-spending plans. He won.

However, the broader dispute about the best way to improve the health service remains unresolved. Mr Brown and many Labour MPs believe that more money combined with demanding national standards and targets are the way to do it. The chancellor goes on about the limits to competition within any health-care system. By contrast, Mr Blair and Mr Milburn believe there must be more choice for patients and competition between providers.

Much of the disquiet among Labour backbenchers arises from fears that the reform will create a two-tier health service. They worry that foundation hospitals will be able to exploit their greater freedoms to the detriment of the rest of the NHS. For example, Mr Brown's rules mean that their borrowing from the private sector will mean there is less available within public-spending limits for other hospitals. They will also have greater freedom to pay higher wages to attract staff.

The simple solution to such worries about a two-tier service is to offer foundation status to all hospitals. That's what Mr Milburn told MPs on March 4th he expected to achieve within four to five years. This would certainly transform the institutional framework of the NHS, but it is unlikely to transform healthcare in the way Mr Blair hopes.

The NHS is no stranger to big shake-ups that promise more than they deliver. The hospital trusts created by the Conservatives at the start of the 1990s were also intended to enjoy new freedoms. That hasn't happened. The big difference this time round is that local people will have a say in electing foundation hospitals' boards of governors. But this is a feeble form of accountability which will have to vie with the scrutiny of the independent regulator. Local control will remain largely notional as long as funds come ultimately from the Treasury.

If the government really wanted to change the way the health service worked, it would give patients more power to choose between providers of health care. Making hospitals a bit freer won't do that: they will remain local monopolies. Furthermore, the focus on reforming hospitals is misplaced. The government should be shifting work out of hospitals—where costs of treating patients are high—and into

doctors' surgeries—where costs are lower. That argues for a bigger role for GPs operating in bigger groups from larger premises. The march towards foundation status will reinforce the position of hospitals within the NHS and weaken the drive to move resources into the primary sector and to allow family doctors to do much more.

The plan to create foundation hospitals may have raised the political temperature in the Labour Party. It is unlikely to lower the temperature of the sick NHS.

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Mar 6th 2003
From The Economist print edition

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Bagehot

Bloody, but how bowed?

Mar 6th 2003
From The Economist print edition

Tony Blair's position is both better and worse than most people think

Get article background

MUCH thought is being given these days to the shape of post-war politics in Iraq. But to the denizens of Westminster, an infinitely more intriguing issue is the shape of post-war politics in Britain.

Tony Blair's most fervent admirers and his fiercest critics agree on at least one thing: the prime minister is risking everything. If he doesn't get that second UN resolution, if the war is bloody and protracted, if the aftermath is messy, if al-Qaeda punishes Britain for its over-enthusiastic support of America, if, in fact, just about anything that could go badly wrong does go wrong, Mr Blair will be in grave trouble.

Some of this is simply the desire to make a drama out of crisis. That the previously unassailable Mr Blair could fall is enough to give any member of the political classes a little shudder of excitement. But, while no one questions that the prime minister is playing for high stakes, what's striking is how much gloating there is at the imagined precariousness of his position.

There's no doubt that nearly all Labour MPs are worried by the idea of using force to disarm Saddam Hussein without explicit United Nations sanction. But most of those who voted last week for the anti-war amendment are part of a coalition of the disaffected and the dispossessed for whom the possibility that Mr Blair might soon get his comeuppance is, if they are honest, jolly appealing.

Apart from the left-wing Campaign Group of MPs who can be relied on to make trouble, there is a far larger number who only reluctantly signed up for the New Labour project and who now regard their loyalty as being severely tested, not just by Iraq but also by issues such as foundation hospitals (part of the government's increasingly desperate attempts to remodel the NHS) and student fees. Prominent among them are some 60 former ministers and front bench spokesmen who, in the last six years, have been either discarded or passed over entirely. It's no coincidence that the Iraq amendment was the work of Chris Smith, the sacked culture minister, or that the prime mover behind a well-supported motion deploring foundation hospitals is the very Old Labour former health secretary, Frank Dobson.

Another factor is the pressure coming from constituency re-selection meetings that are under way in many areas. A lot of pro-Blair party members, who joined for the first time in the mid-1990s, have since faded away, leaving behind a hard core of socialist activists who are both anti-war and hostile to public-sector reform. Some MPs are putting as much distance as possible between themselves and Mr Blair as an insurance policy.

To this already volatile mixture can be added a suspiciously large number of the chancellor of the exchequer's backbench acolytes. What further emboldens the rebels is the belief that, given its huge majority and the desperate state of the Tories, the government would not itself be imperilled in the event of the prime minister meeting a sticky political end.

Unfortunately for Mr Blair, his most voluble fan club these days is on the benches opposite. Grudging respect for the prime minister as a political operator has turned into something close to awe. Perhaps it is a yearning for the smack of firm leadership, but the prime minister's steely resolve makes patriotic Tories go weak at the knees. Unlike the doomsters in the prime minister's own party, they expect the war to achieve its aims and their new hero to be vindicated. In which case life will carry bleakly on. But should the war go badly and brave Mr Blair be forced to make way for Mr Brown, they calculate that Tory prospects would perk up no end. No wonder they egg him on.

In fact, the chances of Mr Blair losing his job over Iraq remain rather slender, albeit not quite as negligible as they appeared a couple of weeks ago. On March 5th, the prime minister promised Parliament that a second resolution would be proposed at the Security Council. Although he is still surprisingly confident it will be passed, Britain is now floating a compromise idea of a “final, final” ultimatum to Saddam Hussein to try to garner enough votes (in which case a French veto is deemed politically bearable). The trouble is that there is no “plan B” if it is not. In that event, Labour's whips have told Mr Blair that he may have to rely on Conservative votes to see the government through—something he has always said would never happen.

No more Mr Nice Guy

But even this calamity need not have anything like fatal consequences for the prime minister as long as a quick war swiftly delivers television pictures of grateful Iraqis vividly describing the toppled regime's innumerable atrocities. The discovery of some of Mr Hussein's beastly weapons would also come in very handy. As this remains the most likely outcome, the really interesting question is not what politics without Blair will be like, but how this searing experience will leave the relationship between Mr Blair and his party.

Blair loyalists, of whom there are still a good many, insist there is no question of slowing down the pace of domestic reform to mend fences with the critics. To them, it is axiomatic that Mr Blair will do what he believes is right just as he has over Iraq. Party discipline will be ruthlessly reimposed, the cabinet will be reshaped in a more perfectly New Labour form and, crucially, the prime minister will explain to Mr Brown once and for all who is really boss—even if this results in a parting of the ways.

All of this is possible, but, arguably, it requires as much wishful thinking as do the scenarios conjured up by those who dream of Mr Blair's demise. Once lost, the habit of discipline is not easily restored. Mr Blair's popularity may recover, but not necessarily his authority. And there is something else. There has never been much affection between Mr Blair and the Labour Party; however the war goes, after it there will be a great deal less.

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The oil industry

A convenient war, perhaps

Mar 6th 2003 | NEW YORK
From The Economist print edition

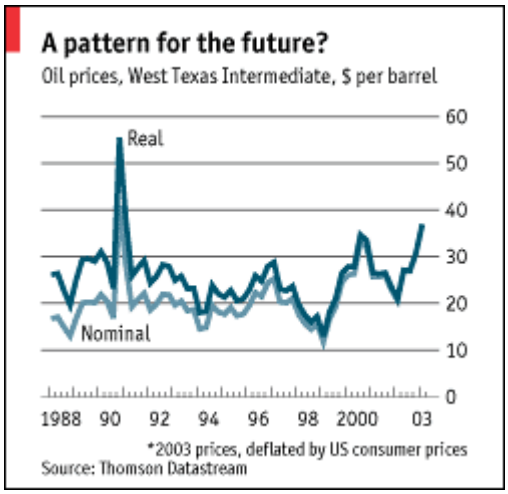
Oil majors are less keen on a war in Iraq than might be expected

Get article background

ON THE eve of the Gulf war, ten years ago, the oil market was tense. Prices spiked before the international coalition moved in to oust Saddam Hussein from Kuwait, but then quickly fell by about half.

The conventional wisdom in the oil business is that such a price rise—and collapse—will recur when the Iraq war begins. Many oilmen argue that the sluggish state of the world economy points to softer prices once the spectre of war is gone (see chart). And Iraq's greater military weakness means, they say, that war is likely to be over quickly. So they expect the current "war premium" for oil quickly to give way, perhaps to prices that fall below $20 a barrel.

This expectation of price collapse may explain the sombre response of the oil majors to what appears to be a golden opportunity to make more money. Every day that prices stay close to $40 a barrel is another day of windfall profits for the majors. Yet in fact, the companies are professing dismay. This week, Lee Raymond, chairman of Exxon Mobil, the world's largest private-sector oil firm, insisted that "we are not at all happy about prices in the high-$30 range."



Other oilmen echo Mr Raymond's views. "A few months of cash generation is not a big deal," says Thierry Desmarest, TotalFinaElf's boss. Mr Desmarest insists that what he wants is "stable, not volatile, prices and a $25 price would be convenient for everybody." In practice, prices are indeed likely to fall after a war. But the collapse that so many oilmen fear is unlikely to occur, for several reasons.

Take, for instance, the position of the Organisation of Petroleum Exporting Countries (OPEC), the producers' cartel. Over the years, when the oil market has overheated, it has usually been Saudi Arabia—the kingpin of OPEC—that has come to the rescue. When oil supplies were disrupted by the Iran-Iraq war

and the Gulf war, it was the desert kingdom that rapidly increased supply to make up the shortfall. Now, Saudi Arabia is promising help again. And, as luck would have it, the cartel is due to hold a summit in Vienna on March 11th.

However, in contrast to the run-up to the Gulf war, OPEC does not have much spare capacity left. Earlier this year, when a political crisis in Venezuela led to a sudden collapse in that country's exports, the Saudis persuaded OPEC members to boost output. OPEC's production rose by some 6% in February, its biggest monthly increase in four years.

As a result, many oil analysts think that the cartel can now offset a disruption of only 2.5m barrels a day or less—half the cushion it had a decade ago. That would be enough to compensate for the loss of Iraq's oil, but not (should the war go horribly wrong) Kuwait's. And do not even think of what might happen if Nigeria's election next month, or a return to political chaos in Venezuela, also cut supplies.

Not only is supply fragile; oil demand is surprisingly strong, in spite of the weak world economy. Winter has been exceptionally cold on both sides of the Atlantic; in America, consumption of residential fuel-oil and diesel fuel is up by a fifth over a year ago. The natural-gas market in America is tight; safety concerns have shut many nuclear plants in Japan. Both these unrelated events have boosted demand for oil as a substitute.

Of stocks and shocks

Demand has risen at a time when inventories are also unusually low. America's Energy Information Administration reports that oil stocks at the end of February stood at 16% below their levels of a year ago, and 12% below the average for the past five years; for residential fuel-oil, stocks are down by 20% from a year ago.

Some of the fall results directly from the need to meet strong demand. In addition, the oil industry carries far less inventory than it did a decade ago. Since its acquisition of Mobil, Exxon has been able to slash $1 billion-worth of inventory from the two firms' lubricants business alone. Across all product lines, say managers, the figure is much higher. Such actions save the shareholders of individual firms money, but they also make the system more vulnerable to disruptions.

Perversely, a shift in government attitudes toward the use of strategic petroleum reserves may be making matters worse. A decade ago, the rich world was slow to use such reserves. Now, stocks are bigger and better co-ordinated; and George Bush has declared his readiness to tap America's strategic reserves when war breaks out. In theory, this should make the world less vulnerable to an oil shock, but in practice it may do the opposite.

Thomas Wallin of the Energy Intelligence Group, an industry publishing company, argues that nobody in the business wants to be caught holding lots of oil bought at today's extravagant prices when governments suddenly flood the market with their reserves. The result is that stocks are actually tighter than they would otherwise be. Mr Wallin worries that “every day the war is delayed, the crude-oil market gets that much tighter, putting further upward pressure on prices.”

Yet every day that passes is also a day closer to spring in the northern hemisphere. Warmer weather in April and May always brings with it a decline in oil demand. Daniel Yergin of Cambridge Energy Research Associates, a consultancy, argues that the diplomatic wrangling that has delayed the start of the war may also reduce its impact on the oil price. The wait could yet prove “the saving grace in all this: the delay brings the market closer to spring when we get that big drop in demand.”

The confluence of tight supply, high demand and low stocks suggests that the oil industry is wrong to fear a dramatic price collapse. Oil markets will probably remain buoyant even if Mr Bush's war against Saddam Hussein turns out to be as swift and relatively bloodless as his father's was in 1991. Prices will surely come down from any pre-invasion spike, says Edward Morse of Hetco, an energy-trading firm, but “it is almost inconceivable that oil prices can crash in a manner similar to what occurred in 1991.”

In fact, prices might well soften to just above the $25 level that Mr Desmarest of France's Total gushes about. If that really does happen, perhaps France, now reviled by many Americans for slowing the march to Baghdad, may come to be remembered as the country that made this war less painful for gas-guzzlers everywhere.

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About sponsorship

Cellular handsets

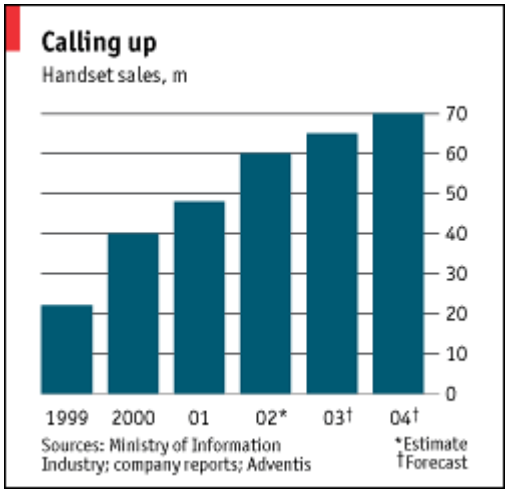
The local touch

Mar 6th 2003 | HONG KONG
From The Economist print edition

Suddenly, China's domestic brands offer serious competition

ONLY last year, the bosses of global mobile-phone companies active in China were still laughing at the handsets offered by TCL, a Chinese manufacturer of television sets that started making mobile phones in 1999. To most foreigners, its faux-diamond ornamentation is egregiously kitschy. But the Chinese love it, and so TCL has passed Siemens and Samsung to become China's third-largest handset vendor after Motorola and Nokia, two firms that it now has in its sights.

Suddenly, nobody is laughing at local brands such as TCL and its two main rivals, Ningbo Bird and Amoisonic. In 1999, they had less than 3% of a fairly small market. Now the market is the world's largest—with about 200m subscribers and 60m handsets sold last year—and domestic brands have 26% of it, according to estimates by Adventis, a telecoms consultancy. Several foreign brands, including Sweden's Ericsson, have all but vanished; America's Motorola and Finland's Nokia still dominate, with half the market between them, but they are rapidly losing share. As if to sum it up, Motorola itself has started copying the diamond-studded decoration it used to deride.



There is something familiar about this evolution. In PCs, another growth market in industrialising China, Legend, a local brand, came from nowhere during the 1990s to pass, and then to leave behind, the big foreign computer-makers. Besides their grasp of Chinese tastes, the main advantage of the locals, in both PCs and handsets, lies in distribution. Whereas the global brands can outspend the locals for billboard space in cosmopolitan Shanghai, the domestic vendors have networks that reach deep into the countryside. Almost every town, for instance, has a TCL branch selling TVs; these branches now offer handsets as well.

At the moment, this edge more than compensates for other weaknesses. As newcomers in the handset business, the Chinese are still learning about after-sales service. Most spend less than 1% of their revenues on research and development, according to CICC, a Chinese investment bank, a small fraction of what foreign brands can afford. And quality still lags—last year, estimates CICC, about 6% of domestic models were returned to the vendor for repairs, twice the rate for foreign models.

But this is changing. Not only are the Chinese catching up, but most of the technology underneath the Chinese-designed shells is foreign. Some 70% of TCL's handsets, for instance, run on chipsets and software from Wavecom, a French company that makes communication modules for wireless gadgets. With the technological playing-field thus levelled, says Aram Hekimian, Wavecom's chief executive, the Chinese brands should be able to capture 80% or more of the market some time in the next few years.

They may not find that entirely a blessing, however. Instead, the handset-manufacturing industry looks likely to repeat a pattern that China has already experienced in white goods, refrigerators, television sets, and many other consumer goods. First, rising incomes make a gadget affordable to millions. Next, the market booms, and companies, irrespective of what industry they originally came from, rush in. Then, the market becomes crowded, and the consequent overcapacity and competition lead to price wars that wipe out profits.

This is now beginning to happen in handsets. Haier, a company still known mostly for its white goods,

Legend, of PC fame, and TCL, a force in TV sets, have all been moving in as their core product ranges become less profitable. In February, Huawei, a respected maker of telecoms switches, said that it too would manufacture handsets.

All in all, 36 producers are now competing. The government, worried about chaos, has said that it will issue no more licences. But well-connected firms such as Huawei, founded by a former PLA officer, will find a way. As a result, handset prices will keep falling much faster in China than elsewhere in the world—by 30% this year, according to estimates by UBS Warburg, an investment bank. Today's group of China's domestic hopefuls may well include tomorrow's world brand: besides TCL, Ningbo Bird and Amoisonic probably have the most potential. But most will simply die, or forever keep expanding into the next industry that promises returns but does not deliver.

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The beauty business

The colour of money

Mar 6th 2003
From The Economist print edition

Unilever and P&G are challenging L'Oréal

IT IS strange to think of two of the world's biggest companies, Procter & Gamble and Unilever, as wallflowers. But when it comes to the beauty business, it is France's L'Oréal that steals the limelight. However, this is something the soap-powder giants are eager to change.

Neither is starting from scratch. Unilever owns such successful cosmetic brands as Calvin Klein and Dove bodycare; P&G, best known for Pampers nappies and Tide detergent, owns Pantene, the global leader in shampoo, Max Factor and Olay, a fast-growing and, by P&G standards, high-priced skin-care range. The American firm also obtained a strong bridgehead in hair colour, a boom area in beauty, with the 2001 purchase of Clairol—at $5 billion, its biggest acquisition.

Nevertheless, it is L'Oréal that dominates the $90-billion-a-year beauty-products industry, in which brand strength and perceived elegance count as much as sales volumes. The French group leads in hair colour in both Europe and America and, by value, dominates the American market in colour cosmetics. L'Oréal's use of sexy celebrities such as Natalie Imbruglia to promote its products, and its seductive slogan—"because you're worth it"—has turned its steep prices into an asset.

This enviable position is increasingly under attack. Since Wella, a German beauty-products company, rebuffed a bid from Henkel, a German rival, last autumn, rumours have swirled of other suitors, including P&G and Unilever. This week, P&G was said to have made a $6 billion offer. Persuading Wella's founding Stroeher family to sell would make P&G a close second to L'Oréal in the professional salon market in Europe, and strengthen it in colour. P&G's ownership of Clairol largely confines it to the United States at present.

P&G's chief executive, Alan Lafley, is the company's first boss to emerge from the beauty business. He has long had his eye on another German beauty company: Beiersdorf, maker of Nivea, the world's biggest skin-care brand. Although talks with its two big shareholders have so far stalled, Mr Lafley is determined to make more deals in this area.

For Wella at least, he may yet face competition from his perennial rival, Niall FitzGerald. Unilever's co-chairman recently admitted that the Anglo-Dutch group had missed the hair-dye boom: "We were slow. We failed to spot this early enough." Meanwhile, Unilever is pressing ahead with the relaunch in Europe of its Sunsilk hair-care range, one of the latest to join its stable of big brands, as well as extending another mega brand, Dove, in America. If Unilever gives its beauty business enough of a makeover, it may even consider splitting it from the low-growth, low-margin food operations, says Iain Ferguson, head of group development and strategy.

In response to these attacks on its top-of-the-range business, L'Oréal is moving downmarket. In February it launched Fructis hair-care in America, its biggest brand launch ever there, in an effort to win shelf space in mass retailers such as Wal-Mart, P&G's biggest customer. With even the most elegant shopper as mindful of her purse as her nails these days, this three-way battle will bring a smile to many a sleekly glossed lip.

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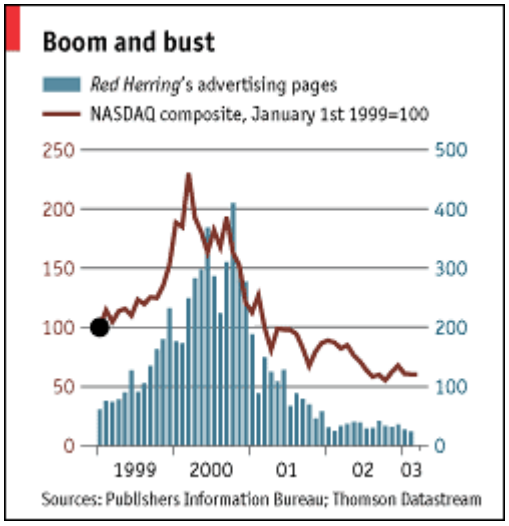
Magazine publishing

What killed the Herring?

Mar 6th 2003
From The Economist print edition

Not what you might think



ANOTHER new-economy magazine bites the dust. The current issue of *Red Herring*, which chronicled the boom and bust of the internet years, will be its last. At its height in June 2000, the magazine had 628 pages, more than half of them advertisements, and was an inch thick. But then the internet bubble burst, ad revenue slumped and the magazine withered to fewer than 100 pages. So was *Red Herring*'s death, like those of *Industry Standard*, *Forbes ASAP* and *Upside*, an inevitable consequence of the collapse of the industry it covered?

Not necessarily. Although the magazine's fortunes seem simply to reflect the level of the NASDAQ stockmarket (see chart), the real story is more complicated. *Red Herring* was launched in 1993, before the boom; the internet was not mentioned until issue six. It covered entrepreneurial and venture-capital activity, taking its title from the nickname for a preliminary share-offering prospectus. Once internet mania had subsided, the magazine returned to its roots, concentrating on venture-capital deals and diversifying into science and biotechnology. Even so, it was inextricably associated with new-economy boosterism, though its coverage of hare-brained dotcommery was often critical.

That was not what killed it, however. The real problem was that the media industry had moved on; there was no going back to 1993. Minnows, whatever their colour, cannot compete in a pond dominated by big fish. Scott Stawski, a media analyst at Inforte, notes that the three high-tech magazines that remain—*Wired*, *Fast Company* and *Business 2.0*—are all backed by media conglomerates. In a recession, he argues, big is beautiful. Large firms can aggregate readers across multiple titles for advertisers and exploit economies of scale. Independent titles such as the *Herring* cannot.

“Why Companies Fail”, an article published in *Red Herring* in October 1999, delineated several fancy ways in which new-economy firms could go bust: “the chasm trap”, “the tornado dive”, and so on. Explaining the *Herring*'s own fate requires no such labelling. The reasons for its demise are more mundane, and reflect the vicissitudes not of a new internet economy, but of the old, paper-based media industry.

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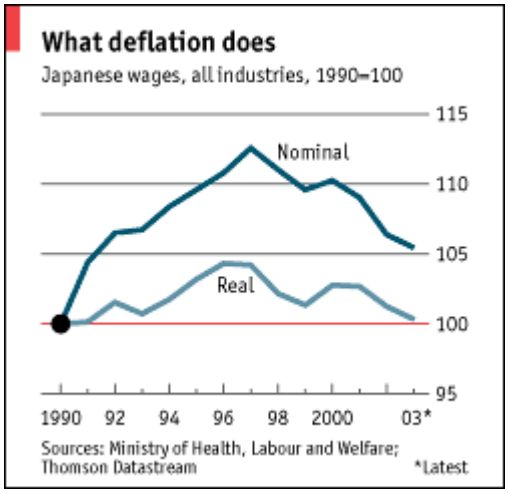
Japan's wage round

Heading down

Mar 6th 2003 | TOKYO
From The Economist print edition

Deflation is transforming Japan's annual pay rituals

ON MARCH 1st, some 22,000 workers gathered in Tokyo for a rally marking the start of *shunto* ("spring livelihood offensive"), Japan's annual round of wage negotiations, which has been held every spring since 1955. Although it was pouring with rain, the turnout was good, say organisers: these are, after all, tough times for Japanese workers.



Indeed, the idea of annual wage negotiations seems oddly anachronistic. The economy is sagging and deflation is spiralling. Unemployment is at record levels, and consumers remain reluctant to spend. High-street prices have been falling for five years running, helping to push profits down. Lifetime employment is crumbling. No wonder last year's wage round yielded the smallest wage increases ever recorded: less than 1.7%.

In fact, workers at struggling firms saw their pay cut anyway. According to government figures, average monthly wages fell by 2.3% in 2002; real wages, adjusted for falling consumer prices, fell by 1.2%. In the short term, at least, the effect will be to exacerbate the deflation that is squeezing corporate profits.

This year's wage-bargaining season, which started last month and ends when management offer their responses to labour demands from March 12th, looks like being even tougher. A feature of *shunto* is that almost all of Japan's thousands of enterprise unions, which represent individual companies rather than whole industries, conduct wage negotiations at the same time. Negotiations cover both pay-scale increases and regular annual wage rises based on age. The whole process, a symbol of the conformity prized by Japanese society, is a relic from the balmy days of the 1960s, when profits were growing and labour shortages were common.

This harmonised approach enabled workers at smaller companies to benefit from the deals struck by bigger unions, which became national trend-setters. In the 1970s, the steel and shipbuilding unions paved the way for broad wage rises. When their industries declined, the electronics companies became the leaders; these days, the car unions set the standard.

That is why unions across Japan reeled at the news in January that Toyota's trend-setting union had made the unprecedented move of giving up (very early in the game, too) pay-scale increases this year. Like others it had demanded—and failed to win—a rise in the pay scale last year. Instead, the top car company, which is expected to make a record-breaking profit of almost ¥1.5 trillion ($1.3 billion) in the year to March 31st, will probably offer a large bonus, and a smaller one-off "reward" to its workers for higher productivity.

There were two reasons for the Toyota union's decision, says Yuji Kato, president of the Confederation of Japan Automobile Workers' Union. One was a realisation that the industry was facing tough international competition, particularly from Asia. The second was a show of deference to Hiroshi Okuda, Toyota's chairman, who heads the Keidanren, a powerful business federation, which stands for company management and is a vocal advocate of both lower labour costs and wage-bargaining reform. Similar announcements followed in quick succession from the Japanese Electrical, Electronic & Information Union, made up of the unions of big consumer-electronics firms such as Hitachi and Fujitsu.

This year, automatic age-related increases are also under threat. Workers at companies fighting for

survival are swallowing wage cuts. But, even at stronger companies, times are changing. Hitachi and Matsushita, another big consumer-electronics firm, are proposing to end automatic seniority-based pay increases after workers reach a certain age, and to shift to performance-based pay structures instead. Last year Canon, the top copier-and-printer company, abolished automatic pay rises for anybody over 32. In the car industry, Mitsubishi Motors wants to abolish its entire seniority-based pay structure this April. So does Honda, another carmaker expecting to make record profits this year: it says it will start lowering wages for underperformers in four years' time.

The unions are now fighting for other things. If base wage levels for workers cannot go up, says Yoji Tatsui, a director in the labour-policy co-ordination division at the Japanese Trade Union Confederation, then companies should at least try to bring pay for part-timers who do similar jobs closer to that of their full-time counterparts. Some companies are beginning to do this, especially in service industries such as retailing, which rely heavily on part-timers. Still, the best news for workers came from Nissan, a car company whose fortunes are rapidly being turned around under its free-thinking president, Carlos Ghosn. Not only is it offering big bonuses this year; it readily acceded to its union demands for a ¥7,000-a-month rise, showing that sometimes good performance does indeed get rewarded.

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Drug patents

Make love, not war

Mar 6th 2003
From The Economist print edition

Viagra under threat

Get article background

NOT content with one male impotence pill, the drug industry will soon sell three. Last month, Cialis, a rival to Viagra, went on sale in Europe and Australasia, promising such benefits as an ability to work for (a somewhat daunting) 24 hours. Cialis will soon be joined by Levitra, whose makers, Bayer and GlaxoSmithKline (GSK), have helpfully built a hint of its utility into its name. Yet in America, men must rub along without these advances: Viagra remains the only approved drug on the market. The little blue pill's maker, Pfizer, hopes to keep it that way. It is suing its rivals for patent infringement.

Even to insiders, patent litigation can be a dauntingly unpredictable business. This week, Pharmacia and Pfizer won a court victory that may save them huge royalty payments to the University of Rochester on Celebrex, a pain-killing drug. And shares in GSK took a sharp knock after a judge in Chicago unexpectedly ruled that a generic competitor to the company's best-selling anti-depressant drug, Paxil, did not infringe GSK's patent. The apparent bone of contention: the amount of water bonded to the rival drug's molecules. Paxil enjoyed global sales of $3.25 billion last year. Now, GSK faces the prospect of competition from cheap generic knock-offs much sooner than the market had expected. Forget horse-racing, says one patent lawyer: “Patent litigation is the true sport of kings.”

Thanks to its inventive tactics, Pfizer is the toast of the track. Most patents cover either a drug's ingredients or the way it is made. Last year, however, America's patent office awarded Pfizer a different sort of patent, covering the way Viagra works. Cialis and Levitra are both made from different substances to Viagra, and therefore do not infringe the original patent. But—surprise, surprise—they both work in the same enzyme-blocking way. If Pfizer can defend its second patent, it gets to keep the competition out of its market, worth about $1.7 billion a year.

Old Europe can enjoy its round-the-clock erections because European countries have thrown out Pfizer's second Viagra patent. Pfizer's American lawsuits, however, have not yet reached trial. Pfizer's arguments failed in Britain, for example, because its patent was ruled too “obvious”: the imaginary skilled but uninventive technician that the courts use to judge such matters was ruled capable of deducing Pfizer's invention from existing public knowledge. Yet it is not clear that the American courts will reach the same conclusion.

The chief reason is that patent disputes are tried by jury in America, but not in Britain and Germany. As Steven Bauer of Testa, Hurwitz & Thibeault, a law firm, points out, jurors must presume that a patent is valid unless proven otherwise, a task that requires a near-criminal burden of proof. Lawyers are forbidden to make any mention of the famous generosity of America's patent office—last year, it granted a seven-year-old boy a patent for a swing. The question of a patent's obviousness is not always so obvious to the average juror. Adding to the uncertainty, says Mr Bauer, a whopping 30-40% of patent rulings are overturned on appeal.

This leaves Viagra's rivals in a pickle. They could go ahead and launch their drugs in America anyway. But Pfizer's lawsuits increase their risk. Should a jury one day find Pfizer's patent valid, its competitors would face penalties that might run into the hundreds of millions of dollars. Stiff, indeed.

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Bid battles

Sick continents

Mar 6th 2003
From The Economist print edition

Hugh Osmond deserves a chance to present his cure

Reuters

The predatory Mr Osmond

IT OFTEN takes a catalyst to get a reaction out of chemicals. The same, sadly, is true of Britain's frequently inert institutional shareholders, as the growing tussle over Six Continents shows. After years of appalling performance, the world's biggest hotels and pubs group agreed to split in two, offering investors £700m ($1.1 billion) in cash as a partial apology, but little in the way of fresh management or ideas. On March 3rd these plans were rudely interrupted when Hugh Osmond, a 40-year-old corporate gadfly who has made a £134m fortune from trading restaurant and pub assets, launched a £5.6 billion offer for Six Continents—just days before an extraordinary general meeting (EGM) on March 12th to approve the demerger.

Suddenly, the group's investors are having to sit up and take notice. After initially dismissing Mr Osmond's offer, some who have met him are considering voting to postpone the EGM to give Mr Osmond time to improve his bid—and perhaps others time to jump in too. Postponement would be sensible (Mr Osmond says he will drop his bid if the demerger goes ahead, though he does not rule out bidding for the pubs alone afterwards). Although Tim Clarke, the boss of Six Continents, claims otherwise, Mr Osmond has a good record in pub management, through Punch Taverns, the second-biggest pub landlord in Britain. And although his bid is largely in shares of his tiny listed shell company, he is offering a cash alternative of up to £1.4 billion—twice what Six Continents has promised.

His strongest card is the weakness of his target. On most key measures—revenue growth, cost control and returns on investment—Six Continents has woefully underperformed its peers, says Jamie Rollo, an analyst at Morgan Stanley. Before bid rumours began last December, its shares were around levels of 16 years ago. Yet the top bosses, albeit reshuffled, are still in place. Richard North, a former finance director and now designated boss of hotels, protests that “there is fresh blood and a complete change of culture” at the company. Yet disgruntled investors are queuing up to hear Mr Osmond's case.

That case has weaknesses. Mr Osmond admits that he knows little about running hotels and wants to sell them. Although he hints that he has buyers, as *The Economist* went to press he had yet to produce one. Disposing of trophy properties at the bottom of the market looks risky, although Mr Osmond insists: “I've never sold an asset on the cheap.” Nor does he come cheap himself. The most audacious part of his bid is the slew of cash and share payments, warrants and advisory fees that would allow Mr Osmond and his partners to trouser more than £1 billion in less than four years if they deliver a 20% annual return. In effect, Mr Osmond is grafting venture-capitalist compensation on to a public bid. Yet he is diluting existing investors and paying them partly with their own cash, loading Six Continents with debt to do it.

Given these drawbacks, investors may be inclined to stick with the original demerger, trusting the (cheaper) existing management to do better. If it doesn't, one or both divisions will surely be bid for, with Britain's Hilton a favourite for the hotels, perhaps alongside America's Hilton Corporation, Starwood or Hyatt.

Still, it would be a pity if Mr Osmond walks away, especially since, in preparing for a split, Six Continents has disclosed information useful to bidders. As Hilary Cook of Barclays Private Clients group (which with

Barclays Global Investors owns 3.5% of Six Continents), says: “He's got a strong argument. This offer ought to be enough to buy Mr Osmond more time.” Mr Osmond could use that time to lay out his arguments properly, improve the structure of his bid and find partners. Already, by highlighting management's failings, he has done shareholders a service. Whether next week's EGM goes ahead or not, his actions mean Six Continents will have to defend or improve its demerger plans. But the surest way to force a radical change would be for shareholders to vote to postpone the EGM. There are few enough real bid battles around these days. It would be a shame to nip such an entertaining one in the bud.

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Face value

Turkey's Berlusconi?

Mar 6th 2003
From The Economist print edition

The tale of Cem Uzan shows the value of doing your homework

AP

WHEN rich countries produce a Dennis Kozlowski or a Bernie Ebbers, who leaves investors licking their wounds and feeling foolish, there is a rush to tighten up rules and improve transparency. Developing countries, however, have been slower to recognise the benefits of transparency. Yet a corporate scandal, especially one where the victims are big international companies, can penalise the whole economy.

Turkey, which yearns to join the European Union and so be firmly integrated into the developed world, sits uneasily on the cusp between the two approaches. One visible sign of the unease is Cem Uzan (his first name is pronounced “gem”), whose business activities are anything but transparent. He is a multi-millionaire businessman and would-be prime minister who has dined on at least three occasions with Prince Charles, heir to the British throne. He is awaiting sentence in New York on charges of racketeering, after a one-day trial on February 19th that neither he nor his lawyers attended. In London, in December, he was sentenced in absentia to 15 months in prison for contempt of court, and he is involved in a string of cases in Turkey.

With his brother and father, Mr Uzan controls many Turkish companies, one of which is Telsim, Turkey's second-largest mobile-phone operator. In the golden days of telecoms, Telsim borrowed $2.7 billion from Motorola and Nokia to enable it to buy the American and Finnish firms' products. The two suppliers allege that Telsim failed to repay their loans, and that much of the money vanished via accounts in the Netherlands Antilles.

At the very least, Motorola and Nokia failed to do their homework on Mr Uzan. Only after their fingers were burnt did they commission a report from Anthony Samuel, a partner in PricewaterhouseCoopers. The report claims that, between 1998 and 2001, “cash (or other assets) of $202m was paid (or transferred) by Telsim to entities controlled by the Uzans individually”, to pay for such things as seven apartments in Manhattan's Trump Tower, four yachts (valued by Mr Samuel at $35.8m), and several aircraft (two of which were “arrested” last month, one in Paris and one near Berlin). The report alleges that other channels were also used to divert money from Telsim. For example, it says that Telsim paid some $283m to Mavi Reklam, an Uzan-controlled advertising agency, for ill-defined services. That was quite a coup, when total annual turnover of Turkey's biggest advertising agency is less than $100m.

In 2000, Mr Uzan employed a London public-relations firm, Bell Pottinger. He had bought a multi-million-

pound house in the city and wanted to be sure he was inviting the right people home. Money helped: he gave some £400,000 ($630,000) to one of Prince Charles's charities. That was enough to get him invited to dinners at Buckingham Palace and at Highgrove, the prince's country estate, where his wife Alara sat next to the prince.

Then, in June 2001, Telsim began to default on its loans, and in January 2002 the charges were filed in New York. Mr Uzan promptly took up politics, where he was well connected. His first big business success had been in partnership with Ahmed Ozal, son of Turgut Ozal, president of Turkey from 1989 to 1993. The two launched a low-brow, high-profit television channel.

Last November, barely three months after he set up a new political party, the Youth Party, Mr Uzan won 7% of the votes in Turkey's general election. He is now thought to be wooing the MHP, a nationalist party that did badly in the election. Seen by some voters as a Robin Hood figure, stealing from those they think of as stealing from them, his nationalist platform (“kick out the IMF”) might have greater appeal if Turkey were spurned by the EU over membership and slighted by the United States after its parliamentary vote against American troop deployment.

Caveat emptor?

Mr Uzan seems to some like a Turkish version of Silvio Berlusconi, Italy's television-owning, judicially-entangled prime minister. His election campaign ran on boyish good looks, forceful nationalism and widespread exposure on the Uzan-owned radio stations (eight of them), television channels (now there are three), and newspapers (two). None of this was enough to win him the 10% of votes required for parliamentary representation, nor the immunity from extradition that goes with it. But any attempt to extradite him by British or American courts could be thwarted by the fact that he and his brother also have Jordanian nationality. Jordan has more limited extradition agreements with Britain and America than does Turkey.

Not surprisingly, the scandal will make it harder for Telsim to purchase equipment and services from abroad. Already there are signs that the company is losing ground. Turkcell, long the only other mobile-phone operator, now has roughly 70% of the market. There is poetic justice in this: Turkcell is the only Turkish company to be quoted on the New York Stock Exchange, and its openness is in sharp contrast to its rival. Telsim, which is audited by Deloitte & Touche, has yet to file its accounts for 2001.

Turkey needs more Turkcells and fewer Telsims if it is to become a country in which foreigners can do business comfortably. But there is a lesson for foreign companies too. The New York judge asked Motorola and Nokia “why they entered into this venture given the already dubious history of the Uzans.” The answer was that Turkey, in 2000, was the fastest-growing mobile-phone market in Europe—with only two corporate players. And when companies are blinded by their own saliva, they can make foolish decisions. Motorola and Nokia may just have to lump it. Racketeering offences in America are liable to treble damages, so a court victory would, in theory, award the two companies not just their lost $2.7 billion but more than $8 billion in damages. But the chance of collecting is tiny: only the gems in Istanbul's Topkapi palace are worth that much.

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Insurance

Poor cover for a rainy day

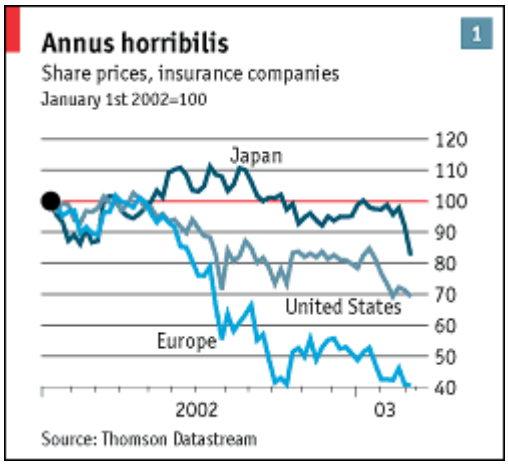
Mar 6th 2003
From The Economist print edition

The insurance industry is in poor shape, particularly in Europe. That's bad news for policyholders

THE past few years have been dreadful for insurance companies in Europe. Even the steady Swiss have stumbled. Last week, Zurich Financial Services (ZFS) reported a huge loss of SFr4.6 billion ($3.4 billion) for 2002, even higher than expected, and it slashed its dividend. Then Swiss Re, a big reinsurer, declared a loss of SFr100m for the year and gave warning that it will also cut its dividend. Winterthur, an insurer that is part of the Credit Suisse group, reported a loss of SFr992m for 2002, during which time Credit Suisse was obliged to pump SFr3.7 billion into the business to keep it afloat.

It is much the same elsewhere. Prudential, a big British insurer, said last week that it may not raise its dividend; and it slashed pay-outs for its 2.1m with-profits policyholders. Legal & General and Aviva, Britain's biggest insurer, said that they might have to apply for a waiver from the solvency requirements of the Financial Services Authority, the country's regulator. And the picture of German insurers is, if anything, worse still.

Insurance companies' share prices have reflected the steady stream of bad news. In Europe, the sector fell last year by 51%, underperforming the European market as a whole by 23 percentage points. Within three years, the insurance industry in Europe has gone from being overcapitalised to being, at best, thinly capitalised. “A few years ago, nobody talked about risk management or the management of assets and liabilities,” says Count Maurice Lippens, one of the founders of Fortis, a Belgian-Dutch firm that combines banking and insurance. “Now the talk of the town is who is solvent.”



One exception amid the general gloom is AXA, France's leading insurer. It made a profit of *euro*949m ($893m) for the year, a rise of 82%. AXA did, however, slice its dividend, though Henri de Castries, the group's chief executive, is optimistic enough to be thinking about acquisitions in America and Europe.

Balancing risks

Insurance companies take two kinds of risk: investment risk and underwriting risk. If they take on too

much of one—by, for example, investing too many of their assets in one volatile market, or by charging premiums that are too low for the risks they are underwriting—they may get into trouble. In general, they hope that their investment income will compensate for their underwriting losses, when they have them, and vice versa. Most European insurers today, though, have got their sums wrong on both counts.

The life insurers tend to be in worse shape than the property-and-casualty (non-life) insurers. The distinction is blurred, however, because most companies do both types of business. Life insurance is the more complex, largely because of its long-term commitments. During the bull market, many firms committed themselves to guaranteed pay-out rates on life-insurance policies which they can no longer afford. Firms such as Equitable Life and Standard Life in Britain have reduced pay-outs and imposed penalties on those who try to cash in early. Non-life insurers tend to renew their contracts every year, so it is easier for them to get out of unprofitable commitments.

American insurers are in better shape because they have taken less investment risk and have tended to be more careful about their underwriting. But they learned the hard way, emerging from an appalling crisis two decades ago. After more than 80 bankruptcies in the second half of the 1980s, the National Association of Insurance Commissioners tightened the rules on investment practices considerably. In particular, it made investment in equities far less appealing.

Japan's insurance industry has been in a state of crisis since the 1980s, after committing itself to unrealistically high pay-out rates on long-term life-insurance policies (for 20 years and more) when interest rates were 5-6%. Since then, bond yields have plunged to less than 1%, with short-term interest rates close to zero, leaving life insurers unable to meet their obligations.

Falling stockmarkets, bad loans (life insurers lent money to firms, too) and plunging property prices have further contributed to their troubles. Six Japanese life insurers have gone bust in the past three years, and the top seven expect their woes to lose them ¥1.1 trillion ($11.8 billion) in the year to March 2003, extending a decade-long run of losses. Could things come to such a pass in Europe too?

Capital concerns

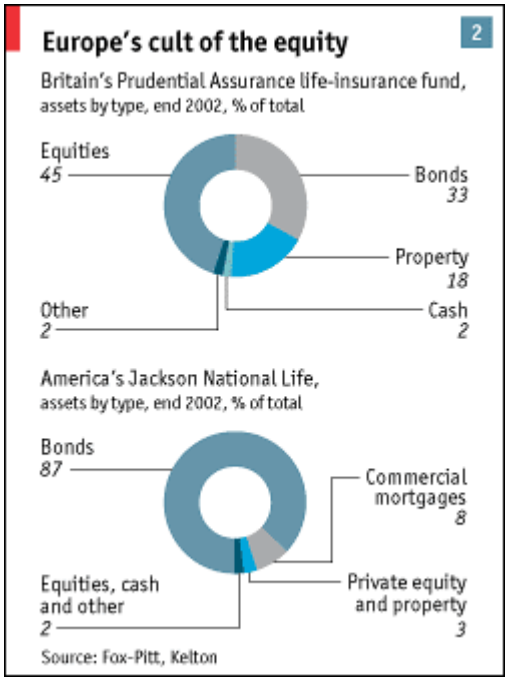
One cause of the Europeans' troubles is an expansionary drive during the bull-market years, when they bought some third-rate companies in America, lured by the size of the market on the other side of the Atlantic. But the biggest reason to worry about their solvency is their over-investment in equities. Three years ago, on average they had 30-40% of their assets invested in equities, though some British insurers had as much as 80%. This is in stark contrast to American insurers, which invest, on average, only about a fifth of their assets in shares.

Regulators in some countries impose a ceiling on equity investment. In Germany, for instance, there is a statutory limit of 35%. In America, the controls are imposed via higher capital requirements for investing in equities.

The argument against allowing insurers to invest too much in equities is that they are supposed to be able to meet their liabilities at all times, and the forced sale of equities in bear markets is not a good idea. But the argument for investment in equities by life insurers (whose liabilities are long-term) is stronger than it is for investment by property-and-casualty (P&C) insurers, whose liabilities are largely short-term. The most cautious insurers believe that equity investment is appropriate only for their so-called “free” reserves, ie, the difference between a company's assets and its technical liabilities.

To strengthen their balance sheets, insurers and reinsurers have become increasingly creative at finding new ways to raise capital. Those most in need have turned to their shareholders with a rights issue. When Legal & General made an £800m ($1.2 billion) issue last autumn it joined an already long queue which included Aegon, Swiss Life and ZFS. Since then, ING, a Dutch financial group, has raised *euro*650m, and Scor, a French reinsurer, *euro*381m via rights issues.

Some P&C insurers raised new capital in order to be able to take on new business, rather than out of any desperation for cash. Since the September 11th attacks, demand for cover in almost all lines of P&C business has increased. A shortage of supply helped push up rates by 15-20% last year. Prices for certain policies—such as aviation insurance or insurance on commercial property—quadrupled.



Hiscox, a British non-life insurer, raised £110m last October to finance its expansionary drive. The company had had a couple of difficult years and could not have taken on much new business without a boost to its capital. "Current conditions are marvellous, but many insurers are eaten up by their past," comments Robert Hiscox, the company's chairman.

Shedding assets has been another way to raise cash and pay for the sins of the past. ZFS sold off its North American operations in February, and its subsidiaries in Mexico, Poland, Hungary and Slovakia in March. Aviva sold its Portuguese insurance arm as well as its insurance operations in Australia and New Zealand in 2002. Royal & Sun Alliance (RSA) disposed of its British asset-management arm, its Benelux subsidiaries, its French car-insurance subsidiary, its operations on the Isle of Man and its German subsidiary.

There is more to come, though buyers are not falling over themselves in the rush. Fortis, for example, is trying to sell its French life business, so far unsuccessfully. AXA does not want its reinsurance arm any more, and Swiss Life would like to part with its non-life business in Belgium, France and Switzerland, and its life operations in Britain, Italy and Spain. Gerling, one of the most troubled German insurers, is also keen to dispose of more assets. But it may not have much time left. On February 28th, Heinrich Focke, its chief executive, ominously announced his resignation, with immediate effect.

The road to reform

The crisis is so severe that European insurers will have to change some of their ways of doing business. This is particularly true for life insurance. "Policyholders will have to carry more risks and policy-providers will have to take less commission," says William Hawkins of Fox-Pitt, Kelton, an investment bank.

Changes are particularly needed in countries such as Germany and Switzerland, where there are statutory minimum pay-outs which mean that business with guaranteed returns is no longer profitable. The German and Swiss authorities recently reduced their statutory guaranteed returns to 3.25%, but this is unlikely to turn their insurers' life business into profit.

It is easier to make non-life insurance profitable than the complex life business. Firms simply need to bring their "combined ratios" (their claims plus expenses divided by their premiums) to less than 100%. AXA's combined ratio, which was 111% in 2001, had been brought down to 106% by last June and will have fallen even further since. Across the board, P&C insurers are raising rates and tightening the terms and conditions of their policies; they are charging more for less in order to make a profit on underwriting.

Fitch, a rating agency, says that despite this it will be a long time before European insurers are well capitalised again. Although non-life insurers are taking steps to improve their balance sheets, the prospect for life insurers doing the same is gloomy, particularly in Britain and Germany. Unless equity markets rally strongly, says Fitch, the creditworthiness of life insurers will be further downgraded.

A recent study by Oliver, Wyman, a consulting firm, is particularly pessimistic about German insurers. Every sixth German company it looked at was only just adequately capitalised, says the firm. Many will have a tough time unless financial markets improve or their governments lend them a hand. On February 24th, Moody's, another rating agency, said that some German life insurers will be under pressure for several years because of their weak capitalisation. Moody's predicts that consolidation of the highly fragmented German life-insurance market will accelerate, as weaker insurers find they can survive only by being taken over.

What if one of Europe's really big insurers were to go under? Lloyd's of London, the insurance market

whose “names” traditionally had unlimited liability, had a near-death experience in 1996, largely due to claims for illnesses related to asbestos. The British government did not intervene and the market had to absorb the world's biggest-ever commercial loss: £8 billion in five years. It bankrupted at least 1,600 of the 34,000 names; now most of its capital comes from limited-liability investors.

“It is very tricky,” concedes Mr Hiscox, a former deputy chairman of Lloyd's. A bankruptcy of one of the big insurers or reinsurers would send shock waves through the financial system, and could have a domino effect, warns Count Lippens. Robert Hartwig at the Insurance Information Institute in New York thinks that too much would be at stake for European governments to remain passive were one of their large insurers or reinsurers to go bust.

Mouldy prospects

The main reason for the relatively better health of American insurers is their different approach to investment risk. Some non-life insurers invest as little as 2% of their assets in equities. Insurers say that the problem with America's regulation, including strictures on equity investment, is the proliferation of different rules in each state. State commissioners, not the federal government, regulate insurance.

Yet all is not well with the industry in America either. P&C insurers are struggling with a host of underwriting problems, many of them stemming from the country's tort system, which allows huge payments for damages. Others are of the industry's own making, such as their experiments with credit derivatives, which have saddled some with big losses.

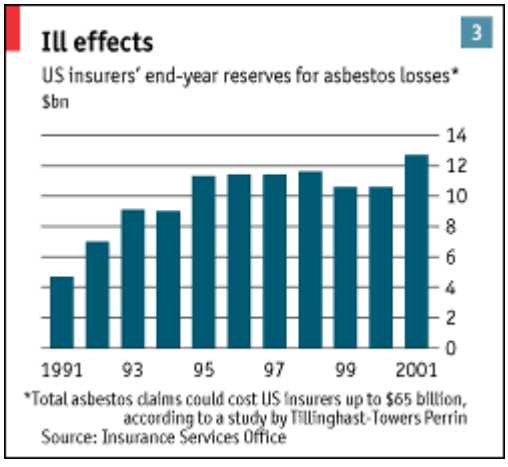
Corporate America is in the throes of a second wave of asbestos lawsuits, many of them brought by people who are not critically ill against companies with only a passing connection to the lethal fibre. Legal wrangles over medical malpractice are another source of huge underwriting losses. In 2001, American insurers paid $1.53 for every dollar of premium they received for medical malpractice, says A.M.Best, an insurance-rating agency. And last year was only slightly better.

Another unexpected source of trouble is claims for damage done by toxic mould. According to the Texas Department of Insurance, the cost of claims for mould damage in Texas increased from $9.1m in the first quarter of 2000 to $79.5m in the first quarter of 2001. Claims for insurance for company directors' liabilities, so-called directors-and-officers insurance (D&O) have also rocketed in the aftermath of America's corporate scandals and the greater responsibility put upon corporate officers by the Sarbanes-Oxley act.

Asbestos won't go away

Even the industry's star—American Insurance Group (AIG), the world's biggest insurer and a role model for its stringent underwriting practices—is not shining so brightly. Shortly before it announced its results for last year, AIG bolstered its reserves for claims relating to D&O, workers' compensation and health care by $2.8 billion. On February 13th, AIG reported a loss for the last quarter of 2002.

The biggest of all the industry's worries remains asbestos. Ace, a Bermudan insurer, and Travellers Property and Casualty have recently increased their reserves for claims related to illnesses caused by asbestos by $1.9 billion and $2.5 billion respectively. Standard & Poor's, a rating agency, is so worried about the adequacy of other insurers' asbestos reserves that it is now reviewing the issue with 27 firms which could be hit by huge claims.



Some 200,000 asbestos claims are currently pending in America, about a third of all those that have been filed since the first lawsuit in 1966 in Beaumont, Texas. Estimates for the final number of complaints range from 1.1m to 2.5m. According to the RAND Institute for Civil Justice, a think-tank in California, about two-thirds of all claims are now filed by the unimpaired, whereas in the past they were filed only by the manifestly ill. Faced with the prospect of endless battles in court, insurers often prefer to pay up. Last May, a dozen insurers settled

with PPG Industries, a chemicals-and-paint manufacturer with a half-share in an asbestos producer, for $2.7 billion to resolve all current and future claims.

Some insurers are also worried about the outcome of their past adventures in the credit markets. Four companies—Ambac, MBIA, Financial Guaranty Insurance Company and Financial Security Assurance—have guaranteed asset-backed securities, such as collateralised debt obligations and credit derivatives, worth $160 billion. Three bad years in the credit market have reduced the value of these, though the extent is unclear thanks to the opacity of the market. Under new accounting rules, insurers are expected to show these assets at market value (“mark to market”). MBIA has denied vehemently allegations that it has understated its mark-to-market losses.

Nevertheless, American insurers are not expected to report big losses or cut dividends in the near future. Although they suffered some losses from defaults on corporate bonds, these were small compared with the blood shed in the equity markets. Colin Devine at Salomon Smith Barney in New York thinks that insurers might even increase their quarterly pay-outs to shareholders if President Bush's proposal to eliminate taxes on dividends is passed. American life insurers, he says, are measurably stronger than their European counterparts.

Asbestos aside, the biggest risk now lies in America's tort laws. Considering the long history of failed attempts to make America a less litigious country, comprehensive tort reform is unlikely. “We may see reform at state level,” says Mr Hartwig. This could mean an end to “forum shopping” by trial lawyers, who look around for the state with the most plaintiff-friendly judiciary. Judges in Alabama, California, Illinois and Texas, for example, have a reputation for being particularly sympathetic to those who sue.

The weakest link

Insurers today look the weakest link in the finance-industry chain. American firms' problems with the tort system are not going to disappear soon, nor are worries about European insurers' capitalisation. Likewise, Japanese companies are not about to rise from their sickbeds.

This is sure to mean that premiums will stay at a high level, or even rise further, in property and casualty. A few years ago, when the industry was still cash-rich, “we thought rates would never increase,” says Mr Hiscox. In life insurance, policyholders will in future have to share more investment risk, by being more flexible about the pay-outs they contract to receive. Ultimately, though, it is existing policyholders who are going to pay the price for the industry's errors of the past.

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Banking in China

Strings attached

Mar 6th 2003 | HONG KONG
From The Economist print edition

Foreign financial firms would love to get into China—without Chinese partners

Get article background

THE prospect is mouth-watering. China has well over $1 trillion in household savings, almost all of it lying fallow in four sprawling and dysfunctional state banks. A mere $16 billion is in mutual funds. But if the Chinese introduce funded pension schemes, says Frank Kusse, boss of the Asian arm of ABN Amro Asset Management, part of a Dutch bank, this should grow to $400 billion by 2010. No wonder so many foreign banks are in a hurry to get into China. The problem is how.

ABN Amro is the latest to try. It has just formed a joint venture with Xiangcai Hefeng, one of China's two dozen fund-management firms, to launch the country's first three “foreign” mutual funds later this month. Others such as Germany's Allianz, America's Invesco, the Belgian/Dutch Fortis, France's Société Générale and the Netherlands' ING are in negotiations to create similar ventures.

Another group of foreigners is following a different route: buying stakes in the handful of Chinese banks that are publicly listed (though still controlled by the state). The four biggest banks are off limits, being wholly state-owned, and are in any case insolvent. In January, Citibank bought 5% of Shanghai Pudong Development Bank, a listed bank. HSBC, British but with deep roots in China, has bought 8% of another, Bank of Shanghai, and is said to be in talks over 15% of a third, Bank of Communications. Newbridge Capital, an American buy-out firm, is pursuing a stake in Shenzhen Development Bank (SDB).

For every deal that promises success, however, there is one that falls apart. ABN Amro succeeded this time only after failing last year, after a tortuous negotiation, to reach a similar agreement with another fund-management firm. And even as ABN Amro declared victory last week, J.P. Morgan Chase admitted that it was walking away from a deal with Huaan, China's most respected fund-management firm. Newbridge supposedly sealed its deal last October but is still waiting for clarification from the Chinese side.

Command and control

The sticking-point in all these ventures, fruitful or not, is control. Asset managers hate joint ventures,

even in a sophisticated market. Many, such as Fidelity, the world's largest retail-fund firm, rule them out on principle. Why, they argue, donate valuable technology and talent without getting the final say over investment decisions, marketing strategy and regulatory compliance? American banks, still reeling from scandals on Wall Street, are particularly adamant on this last point. Besides financial risk, says Stephen Harner, an industry consultant in Shanghai, they fear for their reputation if their Chinese partner is caught playing foul in the markets (as so many Chinese securities firms do).

Banks have a similar aversion to joint ventures, and in China have an extra reason. All Chinese banks are, directly or indirectly, state-run, and the government, local or central, interferes both in the appointment of managers and in lending. There is, therefore, no such thing as a market-driven, meritocratic Chinese bank. Without control, foreign investors will find it difficult to create one.

The Chinese, however, have no intention of yielding control. When China joined the World Trade Organisation in December 2001, it agreed to open up its financial industry, but only gradually. In fund management, foreigners have to enter into joint ventures with local firms. Moreover, they must be minority partners, with a maximum stake of 33% now and 49% from 2005. In banking, foreigners' stakes are limited to 15%. And until 2006, foreigners are barred from conducting local-currency business with Chinese citizens. The only way in is through an investment in a Chinese bank.

What, then, is a foreign investor to do? Newbridge's may have been the shrewdest approach. Guided by an experienced Chinese negotiator, the American firm appears to have finessed the intricacies of Chinese bureaucracy, in effect winning control of SDB. Newbridge chose SDB because it was the only Chinese bank with a large proportion (72%) of its shares in public hands, so that even a small stake could yield practical voting control. Moreover, Newbridge apparently obtained permission for a 20% stake, even though the central bank later set a 15% ceiling for other foreign banks. It also appears likely to win several seats on the board.

Others have simply pushed for the most they can get, short of control. ABN Amro walked away from its first potential joint venture, when its Chinese partner refused to give the Dutch more than 20%. Its new friend, Xiangcai Hefeng, has agreed to the maximum in the fund-management sector. It helped that several of Xiangcai Hefeng's managers had worked abroad, were used to the legalistic western culture, and agreed to put all commitments into writing, including vetoes for ABN Amro in such areas as portfolio and risk management, and compliance.

Even when the relationship is this good, however, foreign banks and fund managers still need to take a leap of faith. For the moment, European companies appear more comfortable than the Americans in doing so. J.P. Morgan's failed relationship with Huaan is an example. Huaan began negotiating with a team that came mostly from Jardine Fleming Asset Management, a British firm with long experience in Asia. However, Jardine Fleming had just been bought by Chase Manhattan, which in turn merged with J.P. Morgan. As these mergers were digested, negotiating priorities changed. “The Americans think that China is just America in the East,” says a European in the industry. “They make absurd requirements on compliance, process and control.”

But is such caution really so absurd? Some deals now in the works could turn out to be embarrassments. Many potential investors, not only in America, are therefore choosing to wait a bit longer before committing themselves to China. After all, as Mr Harner puts it, “the lesson of 20 years of Chinese opening is that it is usually not essential to be among the first.”

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Property prices

Betting the house

Mar 6th 2003
From The Economist print edition

Housing markets in several countries are looking decidedly bubbly

THIS was a week for worrying about housing bubbles. Alan Greenspan, chairman of the Federal Reserve, may have dismissed the idea of a bubble in the United States; but he believes that the house-price boom will slow this year. The IMF said Britain's house prices may be over-inflated, and the OECD fretted about the Australian market (see article). If any of these potential bubbles burst, consumer spending would suffer too.

America's boom is already slowing: the average price of a home rose by 7% in the year to December, compared with an 11% gain during 2001. In the fourth quarter prices rose at an annual rate of only 3.3%, the slowest since 1997. However, according to *The Economist*'s global house-price indicators, markets in many other countries continue to bubble merrily. (We launched these indices a year ago, and plan to update them every six months.)

The Economist's house-price indices 1

House prices, % change on year earlier

	2002, Q4	2001, Q4
Britain	25.3	13.4
Australia	18.4	15.5
Spain	17.7*	20.5
Ireland	11.1	7.3
Italy	9.1	7.9
France	8.4*	7.9
Sweden	9.2	4.8
United States	6.9	10.8
Belgium	6.9*	6.2
Canada	6.7	3.6
Netherlands	4.5	6.9
Germany	-3.3	1.8
Japan	-4.7	-4.3

Sources: Bulwien; ESRI; INSEE; Japan Real Estate Institute; Ministerio de Fomento; Nationwide Building Society; Nomisma; OFHEO; Stadim; national statistics *Q3

Australia, Britain, Ireland and Spain all saw double-digit increases in house prices in 2002. House-price inflation rose in eight of the 13 countries covered in the year to the fourth quarter, but fell in five (see table 1). Prices fell in Germany and Japan, which have yet to recover from the bursting of property bubbles in the 1990s. In both countries prices are lower than in 1995.

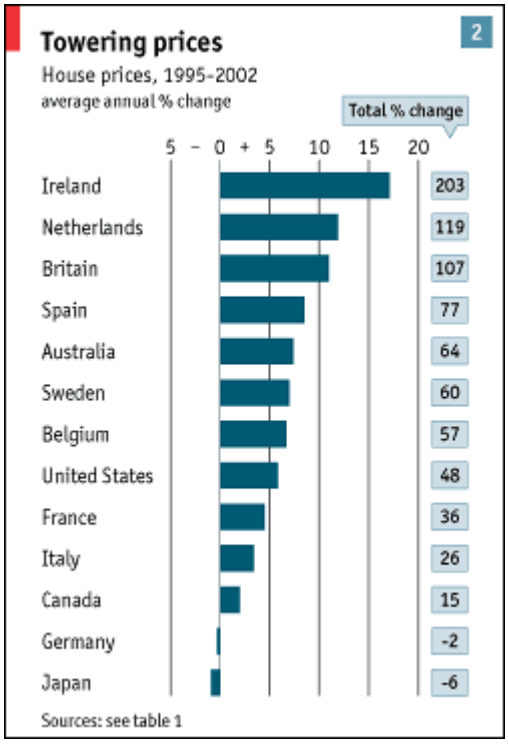
Britain, Ireland and the Netherlands have seen average annual price rises of more than 10% since 1995 (chart 2). But the Dutch bubble is now bursting: prices fell late last year. House prices are also falling in London, if not yet in the rest of Britain. The Irish housing market, which saw a brief fall in prices in 2001, has taken off again. The average Irish home now costs three times as much as in 1995.

Against these price rises, America's house-price boom looks modest. Even so, in real terms the average price gain over the past few years has been the fastest in history. Moreover, national figures conceal local bubbles. Parts of California and New York have seen house-price increases of more than 80% in the past five years.

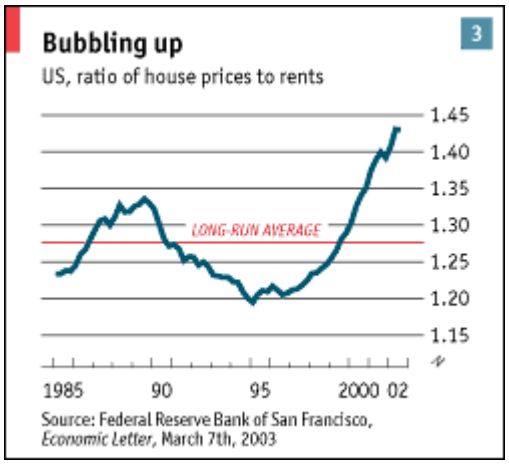
Mr Greenspan acknowledges that there are local hot-spots, but rejects the notion of a national housing bubble, arguing that high transaction costs discourage the buying and selling frenzy seen in financial-market bubbles. (That hasn't prevented housing bubbles elsewhere.) He also sees little sign of an over-supply of new homes, which could later cause prices to plummet.

The commonest argument for why house prices are not overvalued is that low interest rates allow people to borrow more, so they are willing to pay more for their homes. But is it possible to work out some sort of fundamental value of a home? Edward Leamer, an economist at the University of California in Los Angeles, argues

that the price of a house, like that of any other asset, should reflect its future income stream. Just as analysts and investors seemed to believe during the dotcom boom that the link between share prices and profits was irrelevant, people today may have forgotten the link between house prices and the rental income that can be earned if homes are let.



Mr Leamer argues that a price/earnings (p/e) ratio can be calculated for houses, as for shares, by dividing average house prices by average rents. John Krainer, an economist at the Federal Reserve Bank of San Francisco, has calculated this ratio for America's housing market, covering the past two decades. He uses an index of average house prices and the imputed rent paid by owner-occupiers that goes into the consumer-price index. As home prices have outpaced rents, the p/e ratio has soared (see chart 3).



Mr Krainer estimates that house prices would have to fall by 11% to bring the ratio back to its long-run average. In contrast, the p/e ratio for America's S&P 500 stockmarket index suggested in early 2000 that share prices needed to fall by more than 50%. Alternatively, if house prices instead remain constant and rents grow at their average pace of 4% a year, the ratio would revert to its long-term average by the end of 2005, with no need for a price decline. Mr Krainer concludes that, nationally, American house prices are not dramatically out of line with rental values.

But there are two caveats. First, after a boom the housing p/e ratio usually undershoots. That implies either a bigger fall in prices or a longer period of stagnation. Second, it may be too optimistic to assume that rents will rise by 4% a year.

In Britain and Australia, house prices look more out of line. In Sydney and London, prices would have to fall by at least one-third to bring p/e ratios back to their long-term averages immediately. Rising rents could ease the price adjustment, but in both cities rents are falling. Some London landlords have had to reduce rents by 20% in the past year to find new tenants.

This time is different

Nevertheless, housing-market analysts insist that prices will not crash. Lower interest rates, they argue, justify a higher p/e ratio for housing. But future rental income should be discounted using real interest rates—not nominal rates, which are low only because inflation is too. Japan and Germany have learnt painfully that low nominal interest rates are no protection against house-price declines.

Indeed, if homes become seriously overvalued, then low inflation makes a fall in house prices more, not less likely. When inflation was higher, real house prices could fall even if nominal prices did not. Today, with inflation near zero, nominal prices would have to fall.

Granted, nominal house prices have in the past fallen less often than share prices, partly because owners, loth to accept a capital loss, delay selling. The volume of sales, rather than prices, tends to shrink. But times may be changing. The Royal Institution of Chartered Surveyors has found that some homeowners in London, worried about wobbly house prices, are selling and renting, in the hope of locking in a profit before prices fall. Who said bricks and mortar were safe?

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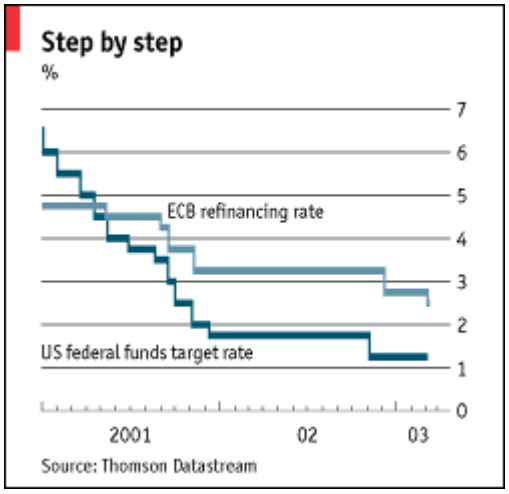
About sponsorship

Euro-area interest rates

Easier does it

Mar 6th 2003
From The Economist print edition

As expected, the European Central Bank has cut interest rates



THE behaviour of the European Central Bank (ECB) seems to be getting easier to predict. Few were surprised when the bank reduced interest rates by a quarter-point, to 2.5%, on March 6th. Markets had been pricing in a cut for almost two weeks, since Wim Duisenberg, the ECB's president, had dropped a heavyish hint. Interest rates in the euro area are now at their lowest since the autumn of 1999. There is still room for further cuts, should the ECB want to make them: rates in America are a mere 1.25% (see chart).

A determined hawk could, just about, have concocted an argument for keeping rates unchanged. Inflation in the euro area, at 2.3%, is still above the top of the ECB's acceptable range. The outlook for oil prices, in particular, is uncertain: producer prices rose by 0.8% in January alone, with energy costs accounting for more than half the increase. And since Mr Duisenberg hinted that a rate cut was on the way, some data, notably surveys, have been surprisingly benign. In stagnant Germany, the euro area's biggest economy, the Ifo index of business confidence rose in February for the second month in a row. So did the euro-area index of purchasing managers' activity, published this week.

The case for a cut, though, was much stronger. Core inflation—ie, excluding food and energy prices—was once stubbornly high, but has now tumbled below 2%. Economic activity, despite the upticks in surveys, remains subdued.

Most striking of all, since the ECB last cut rates—by half a point, in December—the euro, once ridiculed as a currency-market weakling, has been climbing. Three months ago, the euro was around parity with the dollar. This week, it breached $1.10. Its rise in trade-weighted terms has been less dramatic, a bit more than 5%. Nonetheless, an appreciating currency has much the same effect on inflation as a tightening of interest rates, by making imports cheaper and export business weaker. Economists estimate that the euro's rise since December has probably negated that month's interest-rate cut. Given that the economic weather has not improved since—quite the opposite—the case for a further reduction was plain.

This week's cut will do something to placate the bank's critics, in America as well as Europe, who have accused it of reacting too slowly to the apparent stalling of the global economy. But the ECB can expect anything but a quiet few months, and not just because of decisions on interest rates in a difficult economic climate.

Mr Duisenberg is due to retire on July 9th. However, his expected successor, Jean-Claude Trichet, governor of the Bank of France, is on trial for signing the dodgy accounts of Crédit Lyonnais, then a state-owned bank, in 1992, when he was the top official in the French Treasury. A verdict is not due until June 18th—a little close for comfort. So the ECB may still be in search of a new boss. Meanwhile, it is conducting a review of its monetary-policy strategy. And all this with the world on the brink of who knows what.

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About sponsorship

Italian finance

Fiasco

Mar 6th 2003
From The Economist print edition

A quarrel among bankers is undermining Italy's biggest insurer

PICTURE the scene: a senior manager from Generali, Europe's biggest insurer by market capitalisation, is in America, meeting a shareholder who is an important fund manager. The subject is Generali's new three-year strategic plan and its greater transparency and coherence under a management team that was installed last year. The aim is to persuade the fund manager to use his voting rights, helping to counteract the tendency for Generali to be pushed around by Mediobanca, Italy's most influential investment bank. In recent years, Mediobanca, Generali's biggest shareholder with a 13.6% stake, has removed no fewer than three chairmen from the top of the insurer, including Antoine Bernheim, a Frenchman who was reinstalled last September. Mr Bernheim would like to avoid a repeat.

Explaining all this is hard enough. But the meeting is suddenly interrupted. UniCredito, an Italian retail bank, has just announced that it has built a 2% stake in Generali, and wants to protect the insurer's "national identity". The hitherto responsive investor is appalled: "It's the same old Italian bullshit."

Indeed it is. UniCredito's move, which took place on February 28th, threatens to damage Generali's credibility with such investors beyond repair. Despite UniCredito's assertion, the insurer is under no threat of takeover, either by a domestic rival or by a foreign entity. Giovanni Perissinotto and Sergio Balbinot, Generali's two managing directors, have been doing a good job of explaining the company's strengths and strategy, and have been instilling a new spirit of openness.

Generali is the victim of battling bankers who want to reshape Italian finance and, at the same time, to settle personal scores. In one camp are Mediobanca and its boss, Vincenzo Maranghi. In the other is Antonio Fazio, head of Italy's central bank. Their struggle is reminiscent of nothing so much as a feud between scheming Renaissance princes.

Mr Fazio has been after Mr Maranghi for years, but has failed to dish him in previous, direct confrontations with Mediobanca. Now he sees his best chance so far. By loosening Mediobanca's grip on Generali, one of the investment bank's most prized assets, he hopes to weaken Mr Maranghi's position on Mediobanca's board, and may even trigger his resignation when the board next meets on March 14th.

UniCredito's share purchases were only the beginning of that effort. It emerged on March 4th that a consortium of banks had already formed around UniCredito to create what they hope will be a controlling interest in Generali. The consortium needs to gain control before the insurer's annual meeting on April 26th. It is said that UniCredito and its allies already have combined stakes as big as Mediobanca's—including UniCredito's share, now 2.5%, and presumably the 4.7% held by the central bank's pension fund.

Mr Fazio has a strong hand. As boss of the central bank, he has much to say when it comes to approving proposed financial-sector mergers. Consolidation has largely stalled in Italy's over-banked market, but many observers say it is a matter of time before there is a new wave of deals. By asking for bankers' help now, Mr Fazio can imply his co-operation in future. Plenty of ambitious managers have taken note.

That said, Mr Maranghi will not go willingly. He has powerful allies within Mediobanca, who appreciate his dogged efforts to restore the bank to the pre-eminence that it enjoyed under Enrico Cuccia, who died in 2000 aged 92. But Mr Maranghi has increasingly irritated rivals, notably the big commercial banks, by trying to muscle into already complex deals. Last year Mediobanca made two controversial attempts to intervene in the crisis at Fiat, Italy's biggest industrial group. That won it no new friends.

Whatever happens to Mr Maranghi, the real losers are likely to be Generali and its top managers. Efforts

to create a credible international strategy are now compromised. And the new shareholder group, assuming it succeeds, is likely to be as riven by personal feuds as the owners are today. It is the kind of fiasco that any company, not just an Italian one, could do without.

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Wall Street

Selling pessimism

Mar 6th 2003 | NEW YORK
From The Economist print edition

The only hot market is catering to low expectations

THREE years ago, says Nicholas Sargen, chief global investment strategist at J.P. Morgan Chase, his biggest battle was getting clients to be “realistic”, meaning cautious enough not to put everything into equities. Now, it is hard to recall a time when such optimism reigned. With retail investors overwhelmed by losses, the problem faced by investment firms is getting their clients into something more mutually beneficial than cash.

The commonest request is for protection against a further fall in the stockmarket. Put options, which give investors the right to sell their shares at a given price, are a natural choice. It is no surprise that the volume of puts traded on the five top American options exchanges has risen over the past year, making them one of the few product classes in vogue.

As with any popular investment product, however, puts have become expensive, reflecting the premium investors place on safety. Options based on market indices have been selling for more than the standard pricing model would suggest. These prices imply that investors are expecting the stockmarket to be more volatile than it actually has been. The sharp increase in market volatility observed last year has by and large subsided and stabilised. However, implied volatility, which shows up in option prices and reflects investors' expectations, has flared up again since the turn of the year. It now exceeds actual volatility by about one-third, according to Volaris, an investment-management firm (see chart).

In return for protection, plus a share in any upturn in the market, clients have been willing to forgo truly spectacular gains. This was unthinkable during the bubble, but now safety is investors' first concern. In addition, investors may find it easier to give up the chance of making a big return if they feel that the prospect of it is in any case remote.

J.P. Morgan, for example, offers two customised products, each linked to the annual returns of an index based on the broad market. Customers receive either two or three times any market return up to 7% or 8%. Gains are capped at that level. In one of the products, principal is also protected against losses of up to 10%. Below that level, however, investors are exposed to the falling market—and then a tiny bit more. As is common with this sort of product, getting out early is costly. Volaris, which customises option strategies for large investors, began accepting money at the beginning of 2002. It already has $1.4 billion in assets under management.

The question raised by products such as these is whether they allow investors to make money from equity markets even when they fear their volatility. Volaris says that its clients can augment the returns of a conventional portfolio filled with stocks by one, two or even three percentage points. Back in the 1990s, many people would have considered this too trivial an amount even to notice. These days, it would be seen as a roaring success.

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About sponsorship

Economics focus

The lucky country

Mar 6th 2003
From The Economist print edition

Is Australia's economic miracle sustainable?

TO A visitor from the northern hemisphere, Australia is like another planet. Not only does the sun shine there much more at this time of year, but even as the economies of America, Europe and Japan appear to be stumbling for the second time in less than three years, Australia continues to boom. The country is now in its 12th year of uninterrupted economic expansion, having shrugged off both the East Asian crisis of 1997-98 and the global downturn in 2001. Australia's GDP grew at an annual rate of 3.0% in the year to the fourth quarter of 2002. During the past decade it has chalked up annual average growth of almost 4%, the fastest pace of any big, rich country. Not surprisingly, the OECD this week declared the Australian economy to be one of the rich world's best performers.

In part this success is down to sound monetary and fiscal policies, and to structural reforms that have both raised productivity growth and made the economy better able to adjust to shocks. Productivity growth has averaged 2.7% over the past decade, up from 1.6% in the 1980s and well ahead of America's much-acclaimed annual increase of 2.2%. The structural reforms of the past two decades have included a shift from centralised wage fixing to local enterprise bargaining, the introduction of more flexible work practices, the lowering of trade barriers, and the deregulation of product markets and the financial system. But Australia has also enjoyed some good luck. A sharp fall in its currency made producers highly competitive, and, because it has a relatively “old economy” with a small IT sector, it avoided the excesses of the tech bubble. Will its luck hold?

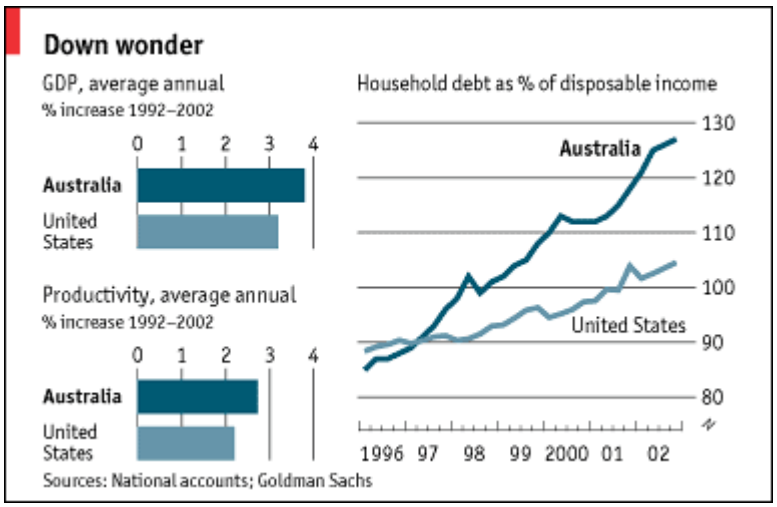
A severe drought cut farm output by 15% in the fourth quarter of last year, but the rest of the economy remains strong. Business investment rose by 19% last year, after several years of weakness, and surveys suggest that it should remain robust in 2003. Strong demand in East Asia, especially China, will also benefit Australia: the region accounts for almost 30% of its exports. Forecasters still expect growth to top 3% this year and next. Even though this is less than the estimated potential growth rate of 3.75%, it is still a figure that Germany or Japan can only dream of. There are, however, three big risks on the horizon that could further dent growth: a global recession, a sharp surge in the Australian dollar and a collapse in house prices.

A lengthy war with Iraq and rising oil prices would increase the risk of a sharp slowdown, if not a recession, in America and Europe. On top of this, the Australian dollar has risen by more than 20% against the American dollar since 2001. Its gain in trade-weighted terms has been more modest, and it remains the most undervalued rich-country currency, according to both *The Economist*'s Big Mac index and more sophisticated gauges. This undervaluation, combined with Australia's outstanding economic performance, may attract large capital inflows and keep pushing the currency up, hurting exports and profits. The currency could even overshoot, and become overvalued.

Blowing the roof off

The biggest worry of all is that the house-price “bubble” could burst. Average house prices have jumped by more than one-third over the past two years, to record levels relative to incomes. Many economists argue that this is justified by lower interest rates, and they expect prices to continue rising, if more slowly. But there are clear danger signals, notably the large number of people buying houses in the expectation of big capital gains. Those buying properties to let, rather than to live in, accounted for more than 40% of all new mortgages approved last year. In the big cities a glut of rental properties has caused an increase in vacancy rates; rents have started to fall. Shane Oliver, chief economist at AMP Henderson, an investment firm, predicts that average house prices will fall by 10-15% over the next two years; but he expects the impact of this on GDP growth to be offset by strong business investment.

The real worry is not house prices, but the mortgage debts incurred by buyers. Australian household debt has jumped from 85% of personal disposable income in 1996 to an estimated 127% by the end of last year—a higher burden even than in the United States (see chart). Home-equity withdrawal (borrowing against the rising value of homes, over and above net new purchases) is running at a record 6% of disposable income. Goldman Sachs estimates that household debt service is at record levels in relation to disposable income, despite low interest rates.



Goldman Sachs has calculated an index of “consumer vulnerability” for 28 economies. This takes account of the level and rate of growth in household debt, the trend in the household saving rate (Australia's has fallen from 4% to an estimated 1% in the past two years), unemployment and the growth in real income. Australian consumers are the most vulnerable on the list. Their excessive debts and a bursting of the housing bubble may not cause a recession by themselves, but they could certainly exacerbate a downturn caused, say, by a global recession.

Nevertheless, most Australian economists remain cheery, expecting the expansion to continue. Indeed, the mood is a bit similar to that in America in 2000, just before its bubble burst. Australians retort that their situation is completely different: America's economic imbalances were much bigger and more widespread than Australia's today. It is true that Australia has not had a stockmarket bubble, and it has also escaped overinvestment and overborrowing by firms. On the other hand, Australia, unlike America at the end of the 1990s, has a house-price bubble, which could be much more dangerous than a share-price bubble if it bursts. Then there are Australian consumers' debts. Australia's current-account deficit (4.4% of GDP last year) is also almost as big as America's.

Australia, just like America in the late 1990s, has enjoyed real productivity gains in recent years. However, there is always a risk that during a boom investors and borrowers can get carried away. Australia's housing market could be as much a victim of irrational exuberance as America's stockmarket has been.

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Military technology

Clipping the enemy's wings

Mar 6th 2003
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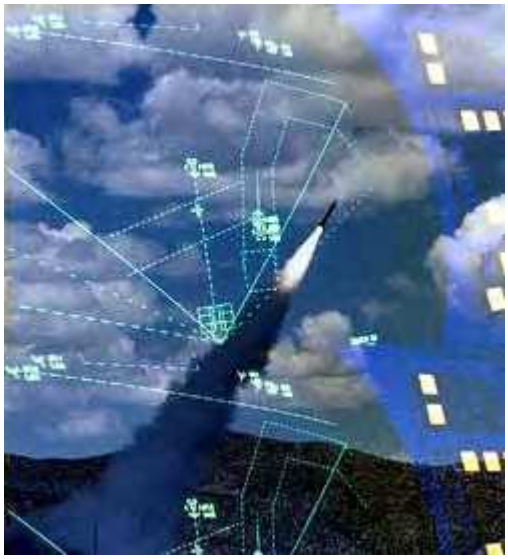
American military technology has moved on a lot since the Gulf war



“THE Yankee clipper is under her sky-sails, she cuts the sparkle and scud.” Walt Whitman's words sound surprisingly apt as America's forces gather in the Gulf to do battle with Iraq's. Cutting the Scud is something that they might well be required to do if the rattling of sabres there leads to hostilities. In theory, Iraq is supposed to have destroyed its Scud missiles, since their range exceeds that permitted by United Nations' resolutions. In practice, the government may have held on to some, and may also have some rather nasty warheads to put on them.

For the past half-century, America has been the world's leader in matters of military technology, such as shooting down enemy missiles. Yet sometimes its claims exceed its reach. For example, it turned out that the Patriot air-defence missiles which were deployed to knock down Scuds when the two sides met in 1991 were not as good at doing so as initial reports had suggested. Nor were the “smart” bombs—dropped from aircraft and guided by laser through doorways or down lift shafts into their target buildings—nearly as effective as some of the television footage shown might have suggested (though they were undoubtedly better than unguided “dumb” bombs). Indeed, America's General Accounting Office rapped the Pentagon on the knuckles for the way it overstated the effectiveness of these weapons.

For military technology, though, 12 years is a long time. Much has now changed. Some people, such as Donald Rumsfeld, America's defence secretary, and his deputy, Paul Wolfowitz, are fervent proponents of a “revolution in military affairs”, which will trade man for machine. That is an exaggeration, at least for now. But technological advances mean that any war fought against Iraq in the near future should resemble the American takeover of Afghanistan in 2001 more than Operation Desert Storm in 1991.

Precise in every part

In Desert Storm, some 1,600 allied aircraft flew about 60,000 attack missions, dropping over 50,000 tonnes of explosives on Iraq. But only 8% of these bombs were guided weapons. Since then, the ratio of guided to unguided weapons has been more than reversed: 98% of the munitions dropped on Serbia in 1999 were “smart”.

More important than the fact that bombs are now guided is how they are guided. The laser systems used in 1991 had two disadvantages: they could not work in cloudy weather, and they required an aircraft or a ground controller to “designate” the target with a laser right up to the moment when the bomb exploded. In contrast, the joint direct attack munitions (JDAM) kit, which smartens up a variety of dumb bombs, and which is likely to account for the bulk of the explosions in any coming war, is guided by the Global Positioning System (GPS)—a satellite network originally designed to allow troops to locate themselves on the ground.

Using GPS location means that JDAM-enhanced bombs can function in all weathers, and also permits the aircraft involved in an attack to retreat in safety, rather than having to guide the bomb home. On top of this, because they convert dumb bombs that have no propulsion system, JDAM kits are cheap: a mere $20,000 a pop, as opposed to nearly $1m for a Tomahawk cruise missile of comparable explosive power

and precision.

According to Loren Thompson of the Lexington Institute, a think-tank in Washington, DC, the air wing of an aircraft carrier could attack 200 targets in one day in 1991. Because the increase in precision means that fewer bombs are needed to dispose of a single target, he says the same group of aircraft could now hit 700 targets. This substantially reduces America's reliance on regional allies, making that country's power to go it alone stronger.

The interception of missiles in flight has also got more precise. The most deadly attack on American forces in the Gulf war occurred when a Scud missile fell on a supply base in Dhahran, Saudi Arabia. Twenty-eight Americans were killed and nearly 100 wounded. Scud attacks like this—and similar attacks on Israel—should be less of a worry this time around. The Patriot missile, retrospectively found to be ineffective in 1991, has been improved considerably. The new generation of Patriots travel half as fast again as the 1991 version, and have at least twice the range—greatly increasing their capacity to intercept incoming missiles such as Scuds.

This capacity is also increased because the new, smaller missiles have radars that can distinguish between different parts of a target missile, ensuring that if the target has broken up, the Patriot attacks the warhead rather than the debris. And the new Patriots can be steered with rocket thrusters as well as fins. This added manoeuvrability means that they can be aimed to destroy an incoming Scud by hitting it at high speed, rather than exploding nearby.

A third, much-discussed technological change since 1991 is the development of unmanned aerial vehicles (UAVs), which promise casualty-free reconnaissance missions, and even (from the bomber's point of view) casualty-free bombing runs. One of these, the Predator, had its first combat outing in the Afghanistan campaign. The Predator, however, may be supplanted in any Gulf war by the Global Hawk, which can loiter for more than 24 hours at high altitude over a battlefield. Other systems, such as the X-45 combat UAV, which are said to be prototypes, may nonetheless see action in such a war. These aircraft might be most useful for ambushing fleeing commanders. A Predator strike in Yemen last November, for example, killed six suspected al-Qaeda members. But for the main part of a war, the value of combat UAVs is still more hype than reality. Smart aeroplane pilots are still indispensable.

More accurate munitions are valuable. But they still have to be dropped on the right targets. Another important advance since 1991 is the ability to choose these on the fly, as it were. Twelve years ago, “tasking orders” (ie, the assignment of particular targets to particular aircrew) were generally compiled day-by-day. A massive target list was assembled at headquarters and disseminated to squadron commanders who then divvied it up among their crews. By contrast, in Afghanistan, a large proportion of the planes took off without set targets and were routed in “real time” by air controllers in the battlefield.

This change is the result of deploying wireless broadband technology. The same underlying time-division technology that is used in GSM-based mobile phones is combined with techniques that rapidly “hop” between frequencies to make the military version resistant to jamming. Aircraft and tanks (and other military hardware as well) link up in a “nodeless” architecture—a battlefield internet—so that any individual need not be in direct communication with headquarters.

Such technology may have its downside, however. As Marcus Corbin of the Centre for Defence Information, another Washington-based think-tank, points out, the ability of headquarters to communicate directly with troops on the ground increases the risk that the general staff will stifle the initiative of field commanders, who are in a better position to assess unfolding situations.

Getting there is half the battle

If warfare has a glamorous side, guided missiles and smart bombs are surely part of it. Just as surely, logistics is not. Yet as Napoleon observed, armies march on their stomachs. They also march with weapons, ammunition, fuel and a mass of other matériel. Moving this in a timely fashion to where it is needed can affect the outcome of battle as surely as can the accuracy of artillery. And this, too, is being improved by technology. Getting a quarter of a million troops to Iraq's periphery is no simple task.

Since 1991, America has invested billions of dollars in new ships that travel faster and have “roll-on, roll-off” loading capabilities, allowing them to bypass time-consuming cranes. It has also started to keep track of its inventory with the sorts of systems used by commercial freight companies to follow consignments. The Joint Total Asset Visibility (JTAV) programme went into operation in October 2000.

JTAV was developed in response to a plague of duplicate orders in the 1991 war. It marks items with bar-codes and RFID-tags (radio-frequency devices that shout back if called), and employs GPS-based systems that allow computers to keep track of where every bit of kit is.

This, plus the use of better databases, makes possible much faster deployment of troops, using fewer ships and aeroplanes. In some cases, it has taken half as many ships and a third as much time to deploy a division (4,000 soldiers) as it did for Desert Storm. Although JTAV cannot actually predict where troops will be sent, once they are in place it allows logistics to become “anticipatory”. For example, it notices when stocks of a given item are low, and automatically sends off replacements.

New vehicles are also part of the process. The C-17, a transport plane that entered service in 1993, can land on dirt airfields, and is more reliable than the rest of the transport fleet (much of which dates from the 1960s). But doctrinal changes are helping too. The Marines are modifying their cargo-handling procedures in order to allow them to unload supplies on an “as-needed” basis, rather than all at once. Previously, deployment was limited by poor-quality airfields or port facilities. That is no longer the case.

Logistics, instead of being a forgotten step-child, is now becoming a driving force. Indeed, the army is rejigging its entire structure around the “Stryker”, a new family of armoured vehicles. The ceramic armour of the Stryker makes it lighter, and thus easier to transport, than conventional tanks. Along with its capability to link seamlessly into the “battlefield internet”, this is a key selling-point of the Stryker. The first Stryker battalion is scheduled for deployment this May, so it could yet see action in Iraq.

Technology alone is but an instrument with which to wage war. America enjoyed a vast technological advantage in 1991, yet it still left Saddam Hussein in place. Satellites can guide bombs, but not policymakers. But technologies like these tilt the odds, already proven to be good in the past, that much further in America's favour. The Yankee clipper seems likely to cut the scud with ease.

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Inbreeding

Consanguinity costs

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Why excessive inbreeding is bad for life

AS ROYAL families and pedigree dog-owners can find to their cost, too much inbreeding may result in individuals who are damaged from birth. The congenital costs of consanguinity have long been recognised, as has their cause: the increased risk that the offspring of an incestuous mating will get two copies of the same damaged gene, one from each parent. The effect of one damaged copy can usually be overcome if a working copy exists as well. If both fail, there is no back-up.

What has not been much investigated is whether consanguinity has more general consequences for an individual's health over its whole life. But a study on wild sea-lions, just published in *Nature*, throws some light on this question. And the answer seems to be that it does.

Karina Acevedo-Whitehouse of Cambridge University, and her colleagues, studied 371 sick sea-lions that had been taken into the care of the Marine Mammal Centre in Sausalito, California. They were able to measure the level of inbreeding in each animal by looking at 11 genetic markers in the animals'DNA. They then classified the animals' sicknesses into six categories, and checked to see which correlated with the degree of inbreeding.

Susceptibility to trauma—ranging from propeller damage to gunshot wounds—did not rise with inbreeding. That is not a surprise, although it is not out of the question that inbreeding might make an animal more accident-prone. But in all other cases—bacterial infection, gut-parasite infestation, cancer, poisoning by toxic algae and even “non-specific”—there was a connection. Inbreeding is clearly bad for sea-lions in all sorts of ways.

It may also be bad for people, so the group is now asking whether such effects can be detected in human populations. In particular, as William Amos, one of Ms Acevedo-Whitehouse's colleagues, points out, levels of inbreeding tend to be lower in expanding populations than in stable ones. This suggests that, as countries become richer, and population growth slows down, they will inevitably become more inbred.

Dr Amos wants to find out whether disorders that are increasing for “no apparent reason”, such as Alzheimer's, autism and allergies, could be related to inbreeding. One study in Africa has already found that inbreeding has an effect on people's propensity to develop tuberculosis.

For some wild animals, this work has more immediate implications. Conservation of the many endangered species which have been reduced to numbers so small that inbreeding is almost inevitable will need to take account of the new knowledge. In particular, the most inbred individuals will cost the most to treat and rehabilitate—and such individuals could also act as reservoirs of infectious agents when they are subsequently released.

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The World Health Organisation

Killjoy woz here

Mar 6th 2003
From The Economist print edition

Health nannying goes intercontinental

Get article background

SWEETS and smokes are the mainstay of many a corner shop. Not for much longer, if the World Health Organisation (WHO) gets its way. In the past few days the WHO has launched a final assault against tobacco, and also begun a new campaign against today's sugar-fuelled, sedentary way of life.

On March 1st, representatives of 171 countries agreed on the text of a treaty that aims to deter smoking across the world. Negotiations on the Framework Convention on Tobacco Control started four years ago. This treaty is meant to be the cornerstone of the WHO's plan to deal with the health risks taken by the world's 1.2 billion smokers. Tobacco consumption is now blamed for 4.9m deaths a year, a toll that is expected to double by 2020.

The treaty attacks smoking on several fronts. It obliges countries to promote treatment to help existing smokers, and education to stop aspiring ones. It requires them to take action to limit public exposure to second-hand smoke. It bans advertising, unless a country has a constitution that protects commercial free speech, in which case it must still strangle advertising as far as its constitution permits. It requires at least 30% of any tobacco product's packaging to be given over to health warnings, and bans the use of such misleading descriptions as “light” or “mild”. And it encourages countries to set taxes at a level that will discourage smoking, and to pass laws holding the tobacco industry to account for medical and other costs.

That adds up to a lot of nannying. But the main argument now will be over the treaty's provisions on advertising. These have already prompted both America and Germany to reserve their endorsement of the text. The treaty's banning of certain voodoo words is also controversial. When a trademark includes one of those words, the treaty could clash with others governing intellectual property, according to Clive Bates, former head of the British arm of Action on Smoking and Health, a lobby group. Even so, the general assumption is that the existing wording will be endorsed when the treaty goes to a vote at the WHO's main assembly in May. It will then be up to individual governments to ratify it and implement its provisions.

WHO knows best

Now that the WHO's attack on tobacco seems to have reached its climax, the organisation is looking for new dragons to slay. It is especially concerned about rising levels of obesity, in rich and poor countries alike. According to WHO estimates, in 2000 there were 302m obese people on the planet, more than a third of them in developing countries. The WHO sees obesity as a big health problem that gives rise to diabetes, cardiovascular disease and cancer.

The blame, not surprisingly, lies in a combination of too many calories, particularly from fatty, sugary, processed foods, and too little exercise—a growing problem in developing countries as they become more affluent. This week the WHO, along with the Food and Agriculture Organisation, another branch of the United Nations, issued a scientific review of the evidence, and a few suggestions for how to tackle the problem. Among the more controversial recommendations is that people should limit their consumption of “added sugars”—those not naturally present in, say, fruit or honey—to less than 10% of their daily intake of calories. This is a stricter standard than that recommended by America's health authorities.

The review will lead to further discussions with governments, lobby groups and companies, intended to

culminate in a global “strategy” on diet, physical activity and health next year. Not only will this provide dietary advice, it will also offer recommendations on how certain foods should be labelled and advertised. While this broad sweep, from medical advice to commercial policy, may sound similar to its attack on tobacco, the WHO is at pains to point out that its approach to dealing with the ill-effects of processed foods, and their manufacturers, is different. There is no question of trying to ban certain foods, and the WHO is keen to engage food manufacturers, rather than spurn them as it has the tobacco industry. Jolly big of it.

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Democracy and freedom

The wilder shores of liberty

Mar 6th 2003
From The Economist print edition

Bridgeman

Is too much democracy bad for you?

FAREED ZAKARIA has a Big Idea. The world, he says, is suffering from a surfeit of democracy. The claim is topical, certainly, and it has profound policy implications. But is it right?

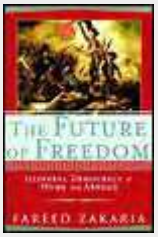
Mr Zakaria's case rests on three claims: that democracy and liberty are not the same; that policymakers and the public overlook institutions and patterns of behaviour that embody liberty, while exaggerating the virtues of those that build democracy; and—most important—that democracy has spread so far that it is now eroding liberty.

On the first point, he is obviously correct. Since Periclean Athens, a slave-owning society, there have been democracies without liberty. For much of the 19th century, America and Britain had a good deal of liberty but not much democracy. It took centuries to combine the two into the constitutional liberal polities of the West. There, as Mr Zakaria writes, liberty led to democracy, not the other way around.

On the second point, he is also correct. Democracy has spread rapidly in the past ten years. There is rejoicing when a country holds its first election. Less attention is paid to the ethnic rivalries and abuse of judicial authority that so often accompany it. In much of the world, democracy predates liberty, and is not working well. Mr Zakaria's account of the undermining of democracy in India, the land of his birth, by crooks, fanatics and the ruling party is a devastating example of failure.

But it is his third point that is controversial. Mr Zakaria asserts that “elected governments claiming to represent the people have steadily encroached on the powers and rights of other elements of society”, such as the courts, local government and the press. In other words, democracy and liberty are not merely different. They are not merely developing at different speeds. Democracy is now spreading at the expense of liberty by feeding ethnic hatreds, precipitating wars or undermining the institutions of liberty.

The Future of Freedom: Illiberal Democracy at Home and Abroad
By Fareed Zakaria



Norton; 270 pages; $24.95

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Amazon.com
Amazon.co.uk

The implication is that if you push, say, China or the Middle East towards democratisation too quickly, you will produce unstable, illiberal regimes. This, he says, is what happened in Russia.

Unexpectedly, the most compelling part of Mr Zakaria's thesis concerns America. By opening up Congress to greater scrutiny, changing campaign finance laws and holding popular referenda, he argues, America has produced a dysfunctional political system dominated by special-interest groups, fund-raisers and lobbyists.

Mr Zakaria goes on to look at the damage democratisation has done below the level of the federal government. Lawyers, accountants, bankers, small-town newspapers and national broadcasters all once combined a degree of public spirit with “we know best” professionalism. That has gone as they seek to chase ambulances and keep pace with mass-markets. Mr Zakaria adds, in an intriguing section, that the democratic impulse is even hollowing out America's churches because of their need to reflect, as well as shape, the beliefs and desires of their congregations. This is a cogent corrective to the usual European notion that fundamentalism is running amok in America.

But America is not Mr Zakaria's main focus: the developing world is. And it is here that his Big Idea begins to get bogged down. He argues that countries need a history of building liberty and an income per head of at least $5,000 if they are to begin sustaining liberal democracy. That gives him just nine candidates, and a strange batch they are—Romania, Belarus, Bulgaria, Croatia, Malaysia, Turkey, Morocco, Tunisia and Iran. Yet many countries have managed the trick without meeting those preconditions, including Japan, Costa Rica and, despite his strictures, India.

He writes rather as if countries face a simple choice between establishing democracy or maintaining incremental reform. In practice, new democracies have often begun because the previous regime had collapsed and there was no other way of establishing legitimacy.

In pursuit of his argument that new democracies undermine civic institutions, he exaggerates some of the bad things they have done. It is not true, for instance, that Boris Yeltsin made the courts weaker. Russia's rule of law today has many problems, but Soviet courts were a sham.

Mr Zakaria tends to blame new democracies for failures inherited from the previous regime (“since it embraced democracy, Indonesia's GDP has contracted by almost 50%”). He gives short shrift to the ways in which democracies encourage liberty, as well as harm it. In practice, for example, they are more likely to guarantee property rights. Yet property rights get barely a mention. And just as he exaggerates the downside of new democracies, so he tends to minimise the drawbacks of the slow process of incremental change. Has China encouraged liberty? Hardly. Will incremental reformers like Kazakhstan or Tunisia prove stable? We do not know.

Illiberal democracies are volatile. That does not necessarily make them worse for themselves or the world in the long run. It is a matter of timing: they get the bad news out early. Reforming autocracies leave tough political problems until later, in the hope they will be more manageable. That is not necessarily an argument against rapid democratisation. Mr Zakaria's book is not an attack on democracy, but on its over-extension. He calls the problem “too much of a good thing”. The same might be said of this book.

The Future of Freedom: Illiberal Democracy at Home and Abroad.
By Fareed Zakaria.
Norton; 270 pages; $24.95

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New fiction

Prometheus unbound

Mar 6th 2003
From The Economist print edition

America's Children
By James Thackara

Overlook Press; 330 pages; $26.95 and £18.99

Buy it at
Amazon.com
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IT IS rare in any novel that characters debate the fate of mankind without an ounce of pretension. Yet the protagonist of “America's Children” reflects on the future of his species as a matter of obligation, not least because he helped to determine it.

James Thackara's trenchant debut novel, which was brought out for the first time in America last year after the success of “The Book of Kings” (Overlook Press, 1999) and is now being republished in Britain after 19 years, dramatises the career of J. Robert Oppenheimer, whose reluctant acceptance of a secret military research post leads him to establish a laboratory in desolate Los Alamos, New Mexico, in 1943. More than one avenue proves a dismal dead-end, and the physicists' search for the ultimate weapon—conducted in feverish haste, as every day lost sacrifices thousands of lives to Hitler—seems a huge waste of money to the army that is backing the project. A genius who feels “fear, almost hatred, in the presence of a common mind”, Oppenheimer is torn between lust for scientific achievement and horror at prospective success.

Mr Thackara's chilling descriptions of the first A-bomb test at Trinity, the bombing of Hiroshima and the tests of the hydrogen bomb—the development of which Oppenheimer fiercely opposed—are terrific. He also captures the ignominy of a McCarthy-era Congress, which questioned the patriotism of a man who took on such an onerous moral burden for his country and which ultimately yanked Oppenheimer's security clearance because of his youthful communist idealism in the 1930s.

Meticulous historical accuracy about this meeting and that acquaintance can impede narrative flow in a novel. And Mr Thackara's grand biblical cadence, while it imparts a suitable majesty to his prose, keeps this complicated protagonist fictionally remote, and ultimately unknowable.

Nevertheless, now that post-cold-war optimism about a new world order has ebbed, the nuclear weapons that are at the core of “America's Children” bring to mind Gerry Adams's notorious observation about the IRA after the celebrated Good Friday Agreement: “They haven't gone away, you know.” As Iraq and North Korea scramble for this unholy grail, Oppenheimer's anguish feels depressingly contemporary.

America's Children.
By James Thackara.
Overlook Press; 330 pages; $26.95 and £18.99

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About sponsorship

Food safety

Cheap chow

Mar 6th 2003
From The Economist print edition

LOBBYING groups often try to disguise a financial self-interest by clumsily dressing up their arguments in the guise of concern for the public. You see this tendency in the pharmaceutical industry and in energy and lumber companies who like to tout their stewardship of the environment. But nowhere, two new books argue, are these tactics more of a cause for concern than in agribusiness.

Marion Nestle's “Food Safety: Bacteria, Biotechnology, and Bioterrorism” looks at the way the American meat and biotechnology industries have campaigned successfully on Capitol Hill against stricter federal regulation, which the author argues has undermined the safety of the food supply. Meanwhile, Maxime Schwartz's “How the Cows Turned Mad” traces the origins of mad-cow disease over more than two centuries, and reveals the fallout from the British government's blind assurances that the disease could not be transmitted to humans.

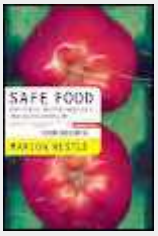
Ms Nestle, who chairs the department of nutrition and food studies at New York University and whose earlier book, “Food Politics”, came out last year, has an ear for a revealing anecdote. In 1999, she writes, Rosemary Mucklow, the executive director of the National Meat Association, lobbied against President Clinton's attempt to establish a more thorough testing regime for *E. coli* 0157:H7, a potentially deadly pathogen, by declaring the move to be just “another step in this administration's obfuscation of the impeachment activities”.

Ms Mucklow's organisation—which represents meatpackers and processors who would have had to discard or reprocess meat found to be infected under the new testing regime—argued on Capitol Hill that increased microbial testing in meat could actually lead to a greater public health risk since confident consumers might relax their own safe-handling procedures at home. Ms Nestle finds similarly fuzzy logic in the biotechnology industry. She tells how “Golden Rice”—genetically engineered to contain beta-carotene—has been promoted with claims that it might help prevent anaemia and blindness in the developing world. Some independent researchers have suggested that an adult would have to eat nine kilos of the rice every day to meet Vitamin A requirements.

There is an implied moral critique here of Janus-faced profiteers who ought really to admit that their arguments are specious. But Ms Nestle's larger beef is that this behaviour has implications for public health. The giant companies that now produce our food have also become potential vectors for mass infection. A single lot of hamburger meat at one processing plant was determined recently to contain parts from 443 different cows. Slaughterhouses that process 300 or more animals an hour and pass them through the same grinders allow a single infected carcass potentially to taint tens of thousands of kilos of meat.

Such opportunity for cross-contamination is especially worrisome in the light of Mr Schwartz's book, which reveals that the alarmingly durable infectious protein, or prion, responsible for mad-cow disease and its human counterpart, variant Creutzfeldt-Jakob disease (vCJD), can survive a formaldehyde bath and heat of 100°C for 30 minutes. Mr Schwartz is a former director of the Institut Pasteur in France, and his book maps out with great clarity the scientific investigation into how scrapie—a disease that has long been known to afflict sheep—came to cross the species barrier to cows, and then from cows to humans.

Safe Food: Bacteria, Biotechnology, and Bioterrorism
By Marion Nestle



University of California Press; 366 pages; $27.50 and £19.95

Buy it at
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How the Cows Turned Mad
By Maxime Schwartz. Translated by Edward Schneider

University of California Press; 238 pages; $24.95 and £17.95

Buy it at
Amazon.com
Amazon.co.uk

Until recently, British and American cattlemen fed their livestock meat-and-bone stuffs to produce heftier and more profitable animals, even though cows are herbivores. The outbreak that resulted from these practices led to the destruction of 4m British cows at an estimated cost of $7 billion. Although epidemiologists at Imperial College, London, recently lowered their forecast of how many people are likely to get vCJD in the coming years from an earlier high of 500,000 to a maximum of 7,000, both these books offer credible arguments that more expensive food may—and perhaps should—be an acceptable price to pay for better food safety.

Safe Food: Bacteria, Biotechnology, and Bioterrorism.
By Marion Nestle.
University of California Press; 366 pages; $27.50 and £19.95

How the Cows Turned Mad.
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About sponsorship

Matthew Barney

Sex, life and video games

Mar 6th 2003
From The Economist print edition

If you don't get it, ask your kids

EPA

Ginger genius

A CRITIC once dismissed Matthew Barney as having “no composition, no structure, no emotion, not even any irony to speak of”. So why has the Guggenheim Museum dedicated its space to him for the next three months?

The answer lies with the artist's daredevil humour and intractable openness which seem to respond particularly eloquently to our rule-bound, post-ironic times. He certainly speaks to the young, who have been flocking to this show ever since it opened last year at the Ludwig Museum in Cologne before travelling on, with similar youthful acclaim, to Paris and now New York.

Though he prefers to call himself a sculptor, Mr Barney is best known for his performance films. A former high-school football star and Yale University biology student, he suddenly came to the notice of the New York art world in 1991 with a filmed performance piece called “Blind Perineum”. Using titanium ice screws and a climbing harness, Mr Barney clambered naked across the gallery's walls and ceilings and into a walk-in fridge that held nothing but a bench press made of cast petroleum jelly.

The five “Cremaster” films that form the core of the Guggenheim exhibition take their name from the testicular muscle that responds to temperature, external stimuli or fear. The erotic and the athletic have always come together in Mr Barney's universe, though his explorations of it are now bigger, better financed and more elaborate than they were a decade ago.

As an artist, he harnesses an impressive narrative talent to a private world—half medical-research laboratory, half training camp—which he creates with the help of prosthetics, wrestling mats and sternal retractors coated in wax, Vaseline and tapioca pudding. The show's curator, Nancy Spector, describes Mr Barney's cycle of films as a self-enclosed aesthetic system, and the project is rife with anatomical allusions to the position of the reproductive organs during the embryonic process of sexual differentiation. “Cremaster 1” represents the most ascended, or undifferentiated, state; “Cremaster 5” quite the opposite. The cycle returns over and over to those moments during sexual development when

the outcome of the process is still unknown, and which represent in Mr Barney's mind's eye a state of pure potentiality.

The films were shot out of order over eight years, from 1994 on, though they allude to each other at every turn. The heady mixture of myth, history, high art and popular culture that they contain refuses to resolve itself into an overall logic, and Ms Spector has honoured this in both the exhibit itself and in its weighty catalogue, which is worth its price for her excellent introductory essay.

Meanwhile, the dramatic energy of the films, which screen continuously during the show, comes from the compelling stillness and solidity of the camera with its high crane shots, slow zoom and proscenium framing. The editing is clean enough that we leave and enter each scene as if it were set on a stage, while the juxtaposition of shots—the films cut back and forth between seemingly disparate narrative patterns—act as an archaeological dig, the camera carefully cutting through layers of imagery.

This, along with Jonathan Bepler's musical scores, creates a sense of impending danger, and it is easy to recognise Mr Barney's taste for the horror genre. “Cremaster”, with its horror-film aesthetic of hybrid creatures and haunted spaces, is filled with characters that challenge the norm and surroundings that stand out, like Stanley Kubrick's hotel in “The Shining”, for their vitality and menace.

Architectural metaphor is also an important element of “Cremaster 3”, the last of the cycle to be shot. The longest—at nearly three hours—and most accomplished of the five films, it takes place mainly in New York's Chrysler Building and the Guggenheim Museum itself. At one point, five 1967 Chrysler Imperials encircle a 1930 model of the same car in the Chrysler Building's lobby, then drive into and smash the older model to pieces, the lobby filling with smoke from their squealing tyres. Meanwhile, Mr Barney, as a character known as the Entered Apprentice, climbs into the building's lift shaft and fills one lift, bucket by bucket, with cement, creating an ashlar—a Masonic symbol of perfection— that eventually causes the lift to plummet to the bottom of the shaft. For this betrayal of the Masonic code, the Entered Apprentice is fitted with a set of metal dentures retrieved from the remains of the destroyed Chrysler Imperial.

In the film's climax, Mr Barney, dressed in a kilt and hot-pink headpiece, climbs the Guggenheim's five levels in a bizarre competition that echoes the structure of a video game, overcoming a number of obstacles including a plastic sheep/bagpipe, a leopard woman played by Aimee Mullins, a double amputee who performed in the Paralympics, and Richard Serra, with his sculptures of hot lead thrown at an empty wall. Mr Serra also plays the Master Mason in the Chrysler segment.

It is in this blend of the video and plastic arts that Mr Barney's talent can best be seen, as any teenager will tell you. But it is in his exploration of his ideas—at once so explosive and so disciplined—that more and more people are coming round to the view of Michael Kimmelman, the critic who has described Mr Barney as the most important American artist of his generation.

“Matthew Barney: The Cremaster Cycle”: at the Guggenheim Museum, New York, until June 11th. Catalogue published by Harry N. Abrams; 544 pages; $65 and £45

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About sponsorship

Going blonde

All the fun of the fair

Mar 6th 2003
From The Economist print edition

NOBODY has distilled the essence of blondeness more perfectly than Raymond Chandler in two hardboiled lines: “It was a blonde. A blonde to make a bishop kick a hole in a stained-glass window.” Blondeness is, and always has been, an ambiguous condition. It can signify sex or saintliness; it is at once the trademark of the man-eater as well as the incorruptible innocent.

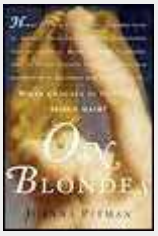
Joanna Pitman teases out this weird ambiguity with reference to the lives of some of history's great blondes, from Aphrodite to Madonna via the Virgin Mary, Elizabeth I and Marilyn Monroe. The book reads like a series of gossipy profiles. Jean Harlow, a 1930s Hollywood siren, had to wear a platinum-blonde wig once she had “reduced her own hair to the consistency of bristles using a diabolical mixture of peroxide, household soap flakes and ammonia.” In the mid-1990s Princess Diana spent £3,600 ($5,600) a year to keep her coiffure a suitably iconic shade of blonde.

How to explain our enduring obsession with blondes and blondeness? Brute Darwinism and the illusion of youth, posits Ms Pitman. Blonde women look younger and reek of fertility.

All this is great fun. But it is a pity that Ms Pitman pitches her historical material at the level of a high-school textbook (“The concept of the angel was hugely popular in the Middle Ages”). There are factual errors, too, as when she twice confuses Lucian, a Greek satirist, with Lucan, a Roman poet. Such oversights show through like dark roots on an otherwise glossy bottle-job.

On Blondes.
By Joanna Pitman.
Bloomsbury; 304 pages; $24.95;
£12.99

On Blondes
By Joanna Pitman



Bloomsbury; 304 pages; $24.95;

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About sponsorship

Peter Smithson

An architect's architect

Mar 6th 2003
From The Economist print edition

Brutal but influential

Jenny Geddes

PETER WHO? Peter Smithson, who died this week at the age of 79, was not well known among the British at large—the people most likely to have seen his work—nor even among those who have come to hate those responsible for so much architectural ugliness in post-war Britain. He was, even so, hugely influential, notably among younger British architects, such as Richard Rogers and Norman Foster, whose work, by contrast, is widely liked.

The buildings that made the reputation of Peter and Alison Smithson—their marriage was intellectual and professional, as well as romantic—were the ones built for *The Economist* in London in 1959-64. The cluster of brutalistic blocks, which include a 14-storey tower quite out of place in low-rise St James's, would not have been tolerated 30 years later. Even in the 1960s, several floors had to be knocked off before planning permission was granted. Now the group is listed as a work of rare merit.

The Smithsons (Alison died in 1993) were a brave, and odd, choice for this commission. Their only major work hitherto had been a school in Norfolk, also notable for its brutalism. Moreover, their approach was firmly based in political ideas which seemed to owe more to socialism than to the 19th-century liberalism of *The Economist*. Another commission, to design a council estate in east London (1963-72), must have seemed much more appropriate: it epitomised the Smithsons' belief in social housing. Grim, cheerless and perpetually vandalised, it is now chiefly seen as an example of awful urban planning.

But the influence of the Smithsons rested much less on their buildings, which are few in number, than on their ideas, and for Peter Smithson building, teaching and theory were all of a piece. This is perhaps why he was so much an architect's architect. Though he may have been the last major British architect to be politically driven, he was one of the first modernists to challenge the kind of doctrinaire town planning then prevailing. The Smithsons rejected the lapidary 1933 Athens Charter, written by Le Corbusier, with its faith in high-rise towers and separated functional zones, and instead proposed “streets in the sky”. Never mind that even these did not work as intended. At least they were an attempt to bring architecture into some sort of harmony with neighbourliness and with people's deep-rooted desire to have a sense of belonging to the place where they live. For that, as much as for anything, Peter Smithson should be remembered.

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About sponsorship

Bernard Loiseau

Mar 6th 2003
From The Economist print edition

Bernard Daniel Jacques Loiseau, a French chef, died on February 24th, aged 52

Corbis

DRIVING from Paris to Bernard Loiseau's restaurant, La Côte d'Or, in the Burgundy village of Saulieu took about three hours, assuming no hold-ups. If it seemed a long way to go for a meal, the reward at the end was nothing as ordinary as the mere appeasement of hunger; it was to experience, Mr Loiseau said, “an explosion of taste in the mouth”. His sauces were said to be among the finest in France, which for many serious eaters meant in the world.

France is fiercely proud of its restaurant and hotel industry. Bernard Loiseau's name “evokes all the perfection of the culinary art and the art of living”, said France's culture minister. When he was president, François Mitterrand pinned the *légion d'honneur* on the overalls of Mr Loiseau, having first personally confirmed the quality of the chef's frog's legs in parsley juice and garlic purée.

As important to Mr Loiseau was being given a top rating of three stars by the Michelin guide, which has a reputation for honesty rare in the catering business. In Britain and the United States many guides carry reviews of restaurants and hotels that they pay for, while newspaper critics tend to be known among restaurateurs, who take care not to poison them. But Michelin, also a tyre manufacturer (19% of the world market), solemnly guards its god-like reputation as the bible of the catering business. The company insists that its 100 or so inspectors remain anonymous and that they are primarily interested in “what is on the plate”.

Not long ago, according to a member of Mr Loiseau's staff, he anxiously asked Michelin if his restaurant was likely to keep his three stars. God declined to say but kindly advised him to “be careful and stay in your kitchen and don't do too much business”. The restaurant kept its stars in the latest guide, but another French guide, GaultMillau, reduced its rating and has been blamed by some of Mr Loiseau's colleagues for driving him to suicide.

That is speculation, but what Mr Loiseau's sad death has made clear is that staying at the top in the restaurant business is cruelly demanding. “There is suffering and fatigue behind the façade,” said a fellow chef.

Star struck

Bernard Loiseau's restaurant had started out as a coaching inn in the 19th century. In the 1930s under Alexandre Dumaine it became one of the best-known restaurants in France, gaining three Michelin stars, all of which were lost when he retired. Mr Loiseau arrived at the now rundown restaurant in Saulieu in 1975, aged 24, “with nothing but my toothbrush”, having worked in various restaurant kitchens since he was a boy. To begin with he provided meals based on what Dumaine had called “the honest elements of French peasant cuisine”. But he was drawn to *nouvelle cuisine*, favoured by GaultMillau (which may have made its recent criticism hard for him to take). He devised the sauces that helped to make him famous that were lighter than those made with butter and cream. Mr Loiseau's weightier customers were especially appreciative. In 1977 his restaurant gained its first Michelin star with Mr Loiseau as chef, in 1981 a second and in 1991 a third, putting him among the 20 or so top chefs in France.

By then Mr Loiseau had become the owner of La Côte d'Or and set about an ambitious transformation of what had been a fairly modest establishment, adding hotel suites, a pool and private dining rooms, and expanding his kitchen. At the end of a meal Mr Loiseau's guests could recall the pleasures of the tummy while strolling in an English-style garden. Before they left they were encouraged to browse in the restaurant shop, where food, wines, kitchen equipment and books of Mr Loiseau's recipes were on sale. At the time Mr Loiseau was said to have borrowed $5m to pay for the work.

He expanded further, buying three bistros in Paris. He licensed his name to mass-market frozen foods. He was, he said, like Yves Saint-Laurent: “I do both high fashion and ready-to-wear.” He became a familiar face on television and on magazine covers. His culinary business traded on the French stock exchange, and its price has been sinking in line with other luxury businesses.

Was Mr Loiseau, so meticulous in the kitchen, an innocent at business? He told a reporter in 1997 that La Côte d'Or had to be full every night, in the restaurant and the hotel, to make any money. Since then luxury businesses have been hit by tighter purses. The current slanging match between America and France may raise a smile when French fries are renamed freedom fries. But it becomes serious when the American tourists who packed a Michelin guide in their luggage are less inclined to visit a country opposed to their government's policy on Iraq.

Yet to remain desirable, a top restaurant dare not be seen to economise. A Paris restaurateur remarked recently that his high fixed-costs of maintaining an appealing establishment with a large staff meant that every customer costs him $70 before he eats or drinks anything. No wonder Mr Loiseau was worried about the possibility of losing one of his precious stars, and a consequent drop in custom. Stick to your kitchen, Michelin had told him. It wasn't bad advice.

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Overview

Mar 6th 2003
From The Economist print edition

The **dollar** hit a four-year low of $1.10 against the euro after comments by John Snow, America's treasury secretary, that he was “not particularly concerned” about the currency's decline. **America's** GDP growth in the fourth quarter was revised up to 1.4% at an annual rate—double the initial estimate of 0.7%. But real consumer spending fell by 0.3% in January.

Australia, **Canada**, **Italy** and **Spain** all reported GDP growth of around 1.5% at an annual rate in the fourth quarter.

Unemployment in the **euro area** rose to 8.6% in January, its highest for almost two years. Spain had the highest rate, at 12.1%. Euro-area retail sales fell by an unexpectedly large 1.9% in the year to December.

Japan's jobless rate rose to 5.5% in January, equalling its record high of October 2002. Its core inflation rate (which excludes the prices of fresh food, and is closely watched by the Bank of Japan) fell for the 40th consecutive month, dropping by 0.8% from a year earlier.

While most central banks are lowering rates, the Bank of **Canada** raised its interest rate by a quarter-point this week, to 3.0%. This followed a spurt in its headline inflation to 4.5% in the 12 months to January. Canada has seen the fastest growth (3.9%) of all the countries in the table over the past year.

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Economic forecasts

Mar 6th 2003
From The Economist print edition

March averages (previous month's, if changed)

	Real GDP, % change				Consumer prices % increase		Current account % of GDP	
	Low/high range		average					
	2003	2004	2003	2004	2003	2004	2003	2004
Australia	2.7/3.7	1.9/4.1	3.1 (3.2)	3.4	2.7	2.9	-4.3(-4.2)	-3.8
Austria	0.3/1.7	1.8/2.4	1.2 (1.3)	2.0	1.7 (1.6)	1.5	-0.7(-0.4)	-1.4
Belgium	0.8/1.8	1.8/2.9	1.3 (1.4)	2.3	1.3	1.5	4.9 (5.1)	5.0
Britain	1.5/2.5	2.0/3.3	2.2 (2.3)	2.7	2.6	2.5	-1.9(-1.8)	-1.8
Canada	2.3/3.5	2.7/4.1	3.0 (3.1)	3.3	2.8 (2.6)	2.3	1.9	2.0
Denmark	1.0/2.3	1.9/2.6	1.8 (1.7)	2.4	2.1	1.9	2.0	1.7
France	0.9/2.0	1.7/3.4	1.4 (1.5)	2.4	1.5	1.4	1.7	1.5
Germany	0.0/0.8	1.3/3.0	0.5 (0.6)	1.9	1.0	1.1	1.7 (1.8)	1.5
Italy	0.7/1.8	1.5/2.7	1.2	2.2	2.3 (2.2)	2.0	-0.2	-0.1
Japan	-0.5/1.3	-0.2/1.3	0.5 (0.2)	0.6	-0.6 (-0.7)	-0.5	2.7 (2.8)	2.9
Netherlands	0.1/1.1	1.9/2.9	0.8 (0.9)	2.2	2.5	2.2	3.1 (2.6)	3.2
Spain	1.7/2.6	2.5/3.5	2.2 (2.3)	2.9	3.0 (2.9)	2.7	-2.0(-2.1)	-2.0
Sweden	1.4/2.5	2.2/2.9	1.9 (2.0)	2.5	2.2 (2.1)	2.1	3.3 (3.2)	3.3
Switzerland	0.5/1.4	1.1/2.7	0.9	1.9	0.7	1.0	10.8	11.6
United States	2.0/3.0	2.1/4.9	2.5	3.5	2.2 (2.1)	1.9	-5.1(-5.0)	-4.0
Euro area	0.6/1.5	1.7/2.7	1.1 (1.3)	2.2	1.7	1.6	0.9 (0.8)	0.8

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordea, Decision Economics, BNP Paribas, Royal Bank of Canada, Schroder Salomon Smith Barney, Scotiabank, UBS Warburg

Every month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's forecasts, where different, are shown in brackets. This month we include, for the first time, forecasts for 2004. Our panel has become gloomier about the euro area, where GDP is now forecast to grow by only 1.1% this year, and by 2.2% in 2004. In contrast, America's economy is tipped to grow over the two years by 2.5% and 3.5% respectively. If it does, it would enjoy the fastest growth next year of all the countries in the table, beating Australia's expected growth of 3.4%. Japan is once again tipped to be the slowcoach in 2004, with GDP growth of only 0.6%.

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Output, demand and jobs

Mar 6th 2003
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate	
	1 qtr*	1 year	2003	2004	latest		latest		latest	year ago
Australia	+ 1.6	+ 3.0 Q4	+ 3.1	+ 3.4	+ 1.6	Q3	+ 5.4	Q4	6.1 Jan	7.0
Austria	+ 0.3	+ 1.2 Q3	+ 1.2	+ 2.0	– 1.5	Dec	+ 0.9	Dec	4.1 Jan	3.9
Belgium	+ 0.8	+ 1.6 Q4	+ 1.3	+ 2.3	– 0.8	Dec	– 4.9	Dec	11.8 Feb†	10.8
Britain	+ 1.3	+ 2.1 Q4	+ 2.2	+ 2.7	– 1.4	Dec	+ 4.2	Jan	5.1 Dec††	5.2
Canada	+ 1.6	+ 3.9 Q4	+ 3.0	+ 3.3	+ 5.6	Dec	+ 2.4	Nov	7.4 Jan	7.9
Denmark	– 0.1	+ 0.9 Q4	+ 1.8	+ 2.4	– 1.7	Dec	+ 2.4	Dec	5.4 Dec	5.1
France	+ 0.9	+ 1.7 Q4	+ 1.4	+ 2.4	– 0.1	Dec	– 1.9	Dec	9.1 Jan	8.8
Germany	– 0.1	+ 0.5 Q4	+ 0.5	+ 1.9	– 1.4	Dec	+ 1.3	Jan	10.5 Feb§	9.6
Italy	+ 1.5	+ 1.0 Q4	+ 1.2	+ 2.2	+ 2.1	Dec	+ 1.9	Nov†	8.9 Oct	9.3
Japan	+ 2.0	+ 2.6 Q4	+ 0.5	+ 0.6	+ 1.5	Jan	– 3.0	Dec	5.5 Jan	5.3
Netherlands	+ 0.4	+ 0.3 Q4	+ 0.8	+ 2.2	– 6.8	Dec	– 2.5	Dec	4.3 Jan**	3.4
Spain	+ 1.4	+ 2.1 Q4	+ 2.2	+ 2.9	+ 2.5	Dec	+ 4.8	Nov‡	12.1 Jan	10.9
Sweden	+ 1.6	+ 2.0 Q4	+ 1.9	+ 2.5	– 2.0	Dec	+ 4.3	Jan	5.1 Jan†	4.4
Switzerland	+ 1.4	+ 0.8 Q4	+ 0.9	+ 1.9	– 3.5	Q3	– 2.8	Dec	3.8 Jan†	2.6
United States	+ 1.4	+ 2.9 Q4	+ 2.5	+ 3.5	+ 2.0	Jan	+ 4.3	Jan	5.7 Jan	5.6
Euro area	+ 1.2	+ 0.9 Q3	+ 1.1	+ 2.2	– 0.5	Dec	– 1.9	Dec	8.6 Jan	8.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*									
Finland	+ 2.8	+ 2.8 Q4	na	na	+ 0.3	Jan	+ 2.0	Nov	9.5 Jan†	9.9
Greece	na	+ 3.6 Q3	na	na	+ 5.0	Dec	na		na	na
Iceland	na	+ 3.62001	na	na	+12.2	2001	na		3.8 Jan	2.4
Ireland	na	+ 6.9 Q3	na	na	– 6.6	Dec	– 0.4	Dec	4.5 Jan†	4.2
Luxembourg	na	+ 1.02001	na	na	+ 1.9	Nov	– 6.1	Oct	3.4 Dec†	2.7
New Zealand	+ 5.0	+ 5.0 Q3	na	na	+ 5.1	Q3	+ 7.3	Q4	4.9 Q4	5.4
Norway	– 0.9	+ 1.0 Q3	na	na	– 4.4	Dec	+ 2.7	Jan	3.7 Q4	3.3
Portugal	na	– 0.5 Q3	na	na	– 1.8	Dec	– 3.5	Dec	6.2 Q4†	4.2

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Oct-Dec; claimant count rate 3.1% in Jan. §EU harmonised rate 8.6% in Jan. **Nov-Jan, new series

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Prices and wages

Mar 6th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 3.0	Q4	+ 3.1	+ 2.7	+ 2.9	+ 1.6	Q4	– 0.7	+ 3.9	Q4	+ 4.9
Austria	+ 1.7	Jan	+ 2.1	+ 1.7	+ 1.5	+ 1.4	Jan	– 0.4	+ 2.2	Jan	+ 2.5
Belgium	+ 1.7	Feb	+ 2.6	+ 1.3	+ 1.5	+ 1.1	Jan	– 1.6	+ 2.2	Q4	+ 3.1
Britain	+ 2.9	Jan	+ 1.3	+ 2.6	+ 2.5	+ 1.6	Jan	– 0.6	+ 3.7	Dec	+ 3.4
Canada	+ 4.5	Jan	+ 1.3	+ 2.8	+ 2.3	+ 2.0	Jan	– 1.1	+ 2.1	Nov	+ 3.1
Denmark	+ 2.6	Jan	+ 2.5	+ 2.1	+ 1.9	+ 1.3	Jan	+ 0.6	+ 3.9	Q3	+ 4.3
France	+ 2.0	Jan	+ 2.2	+ 1.5	+ 1.4	+ 2.1	Jan	– 1.1	+ 3.4	Q3	+ 4.2
Germany	+ 1.3	Feb	+ 1.8	+ 1.0	+ 1.1	+ 1.2	Jan	+ 0.2	+ 2.7	Dec	+ 2.2
Italy	+ 2.6	Feb	+ 2.3	+ 2.3	+ 2.0	+ 1.5	Dec	– 1.3	+ 2.1	Dec	+ 2.8
Japan	– 0.4	Jan	– 1.4	– 0.6	– 0.5	– 1.0	Jan†	– 2.7	+ 0.5	Jan	– 2.7
Netherlands	+ 2.5	Jan*	+ 4.0	+ 2.5	+ 2.2	+ 4.3	Jan	– 1.9	+ 3.0	Jan	+ 4.3
Spain	+ 3.7	Jan	+ 3.1	+ 3.0	+ 2.7	+ 2.6	Jan	+ 0.1	+ 3.8	Q3	+ 3.6
Sweden	+ 2.8	Jan	+ 2.9	+ 2.2	+ 2.1	– 0.2	Jan	– 0.5	+ 4.0	Dec	+ 3.2
Switzerland	+ 0.9	Feb	+ 0.6	+ 0.7	+ 1.0	– 0.2	Jan	– 1.4	+ 2.5	2001	+ 1.3
United States	+ 2.6	Jan	+ 1.1	+ 2.2	+ 1.9	+ 2.8	Jan	– 2.7	+ 2.7	Jan	+ 3.8
Euro area	+ 2.3	Feb	+ 2.5	+ 1.7	+ 1.6	+ 2.0	Jan	– 0.8	+ 3.3	Q3	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.4	Jan	+ 2.3	na	na	+ 1.4	Dec	– 2.7	+ 3.3	Q4	+ 4.5
Greece	+ 3.1	Jan	+ 4.4	na	na	+ 0.5	Jan	+ 5.2	na		na
Iceland	+ 1.5	Feb	+ 8.9	na	na	+ 3.5	Mar	+ 9.6	+ 5.5	Jan	+10.0
Ireland	+ 4.8	Jan	+ 4.9	na	na	– 0.6	Dec	+ 0.2	+ 6.2	Q3	+ 8.1
Luxembourg	+ 2.3	Jan	+ 2.3	na	na	+ 1.2	Dec	– 2.0	+ 3.5	Nov	+ 4.2
New Zealand	+ 2.7	Q4	+ 1.8	na	na	– 0.9	Q4	+ 1.8	+ 2.1	Q4	+ 2.2
Norway	+ 5.0	Jan	+ 1.3	na	na	+11.6	Jan	– 8.2	+ 5.2	Q4	+ 4.4
Portugal	+ 4.0	Jan	+ 3.5	na	na	+ 2.3	Jan	– 0.5	+ 0.2	Dec*	+ 2.2

*Revised series.

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Money and interest rates

Mar 6th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Mar 5th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 9.7	+10.4	Jan	4.78	4.33	4.29	4.98	6.12	6.02
Britain	+ 5.1	+ 6.4	Jan	3.63	4.00	3.19	4.12	5.15	5.93
Canada	+ 6.7	+ 4.9	Jan	3.01	2.07	3.54	4.91	5.55	6.81
Denmark	+ 7.4	+ 9.1	Jan	2.70	3.70	2.54	4.04	5.28	6.78
Japan	+23.6	+ 2.0	Jan	0.02	0.07	0.04	0.76	1.47	0.87
Sweden	– 0.1	+ 4.3	Dec	3.41	4.03	3.37	4.35	5.52	3.84
Switzerland	+13.2	+ 8.0	Jan	0.56	1.77	0.12	2.17	3.58	3.38
United States	+ 2.9	+ 6.2	Jan	1.23	1.81	1.29	3.62	5.04	5.87
Euro area†	+ 9.8	+ 7.4	Jan	2.48	3.37	2.25	3.83	5.09	4.31

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.74%, Japan No.247 0.77%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.75%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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Stockmarkets

Mar 6th 2003
From The Economist print edition

Market indices

	Mar 5th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	2,749.7	3,049.6	2,749.7	- 1.9	-20.1	- 7.6	+ 1.2
Austria (ATX)	1,159.4	1,187.8	1,135.5	+ 1.3	-33.3	+ 0.8	+ 5.4
Belgium (Bel 20)	1,608.1	2,074.1	1,608.1	- 1.2	-56.3	-20.6	-16.9
Britain (FTSE 100)	3,563.5	4,009.5	3,480.8	- 0.8	-48.6	- 9.6	-10.1
Canada (Toronto Composite)	6,389.9	6,837.3	6,389.9	- 1.8	-43.9	- 3.4	+ 3.8
Denmark (KBX)	149.1	173.2	148.4	+ 0.2	-50.6	-10.3	- 6.2
France (SBF 250)	1,783.3	2,144.8	1,783.3	- 0.3	-59.4	-13.1	- 9.2
(CAC 40)	2,655.1	3,210.3	2,655.1	- 0.1	-61.6	-13.3	- 9.4
Germany (DAX)	2,498.0	3,157.3	2,450.2	+ 2.0	-69.0	-13.6	- 9.7
Italy (BCI)	1,044.0	1,142.4	1,018.5	- 0.7	-52.2	- 4.4	nil
Japan (Nikkei 225)	8,472.6	8,790.9	8,316.8	+ 1.4	-78.2	- 1.2	nil
(Topix)	822.8	865.4	760.1	+ 0.5	-71.5	- 2.4	- 1.2
Netherlands (AEX)	253.5	337.3	253.4	nil	-63.9	-21.4	-17.8
Spain (Madrid SE)	618.0	683.8	607.0	+ 1.8	-46.1	- 2.5	+ 2.0
Sweden (Affarsvarlden Gen)	135.1	153.4	134.2	+ 0.2	-66.3	- 7.0	- 3.2
Switzerland (Swiss Market)	3,966.2	4,965.3	3,966.2	- 2.1	-52.9	-14.4	-10.9
United States (DJIA)	7,775.6	8,842.6	7,704.9	- 0.4	-33.7	- 6.8	- 6.8
(S&P 500)	829.9	931.7	817.4	+ 0.3	-45.7	- 5.7	- 5.7
(NASDAQ Comp)	1,314.4	2,359.5	1,277.4	+ 0.8	-74.0	- 1.6	- 1.6
Europe (FTSE Eurotop 300)*	745.8	890.8	745.8	- 0.3	-56.3	-13.0	- 9.0
Euro area (FTSE Ebloc 100)*	627.6	757.2	623.3	+ 0.7	-59.5	-12.6	- 8.6
World (MSCI)†	745.8	830.7	741.1	+ 0.6	-48.5	na	- 5.9
World bond market (Salomon)‡	547.6	547.6	518.6	+ 1.2	nil	na	+ 4.2

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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About sponsorship

Trade, exchange rates and budgets

Mar 6th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Mar 5th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Mar 5th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2002‡
Australia	− 6.0 Jan	− 17.7 Q4	− 4.3	− 3.8	78.2	74.7	1.62	1.92	2.60	1.75	1.38	0.1
Austria	+ 0.4 Nov	+ 0.8 Dec	− 0.7	− 1.4	101.3§	100.3	0.91	1.15	1.46	–	0.78	-1.6
Belgium	+ 17.5 Dec	+ 18.0 Nov	+ 4.9	+ 5.0	100.7§	99.0	0.91	1.15	1.46	–	0.78	nil
Britain	− 51.8 Dec	− 20.5 Q3	− 1.9	− 1.8	100.4	106.6	0.62	0.70	–	0.67	0.53	-1.4
Canada	+ 34.7 Dec	+ 11.0 Q4	+ 1.9	+ 2.0	79.8	76.3	1.47	1.59	2.35	1.59	1.26	0.6
Denmark	+ 8.0 Dec	+ 5.0 Dec	+ 2.0	+ 1.7	105.4	101.7	6.77	8.55	10.8	7.30	5.78	2.2
France	+ 9.7 Dec	+ 28.3 Dec	+ 1.7	+ 1.5	103.7§	101.7	0.91	1.15	1.46	–	0.78	-2.7
Germany	+119.3 Dec	+ 50.4 Dec	+ 1.7	+ 1.5	100.8§	98.6	0.91	1.15	1.46	–	0.78	-3.7
Italy	+ 8.9 Dec	− 6.4 Dec	− 0.2	− 0.1	74.0§	72.6	0.91	1.15	1.46	–	0.78	-2.3
Japan	+ 94.1 Dec	+115.0 Dec	+ 2.7	+ 2.9	132.1	129.8	117	132	188	126	–	-7.9
Netherlands	+ 29.0 Dec	+ 9.1 Q4	+ 3.1	+ 3.2	99.9§	98.0	0.91	1.15	1.46	–	0.78	-0.8
Spain	− 38.7 Nov	− 15.3 Nov	− 2.0	− 2.0	75.5§	74.3	0.91	1.15	1.46	–	0.78	nil
Sweden	+ 15.0 Jan	+ 9.9 Dec	+ 3.3	+ 3.3	79.3	77.0	8.37	10.4	13.4	9.03	7.15	1.7
Switzerland	+ 4.1 Jan	+ 29.8 Q3	+10.8	+11.6	117.5	111.6	1.33	1.70	2.13	1.43	1.13	na
United States	−484.3 Dec	−462.2 Q3	− 5.1	− 4.0	106.4	122.8	–	–	1.60	1.08	0.85	-3.1
Euro area	+ 97.7 Dec	+ 60.2 Dec	+ 0.9	+ 0.8	87.4	78.1	0.91	1.15	1.46	–	0.78	-2.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.2 Dec	+ 10.3 Dec	na	na	79.6§	78.5	0.91	1.15	1.46	–	0.78	3.2
Greece	− 21.5 Dec	− 9.0 Dec	na	na	58.3§	57.5	0.91	1.15	1.46	–	0.78	-1.1
Iceland	+ 0.1 Jan	nil Q3	na	na	92.1**	83.4	76.7	101.5	123	82.8	65.5	0.3
Ireland	+ 36.0 Dec	+ 0.1 Q3	na	na	90.3§	87.4	0.91	1.15	1.46	–	0.78	-0.5
Luxembourg	− 3.1 Dec	+ 2.1 Q3	na	na	100.7§	99.0	0.91	1.15	1.46	–	0.78	1.8
New Zealand	− 0.8 Jan	− 1.7 Q3	na	na	97.7	83.2	1.77	2.34	2.83	1.91	1.51	1.6
Norway	+ 26.8 Jan	+ 25.9 Dec	na	na	102.8	98.7	7.05	8.83	11.3	7.61	6.02	12.4
Portugal	− 12.9 Nov	− 9.9 Dec	na	na	91.1**	90.2	0.91	1.15	1.46	–	0.78	-3.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average. ‡OECD estimate. **IMF, October average.

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About sponsorship

The Economist commodity price index

Mar 6th 2003
From The Economist print edition

1995=100

	Feb 25th	Mar 4th*	% change on one month	% change on one year
Dollar index				
All items	78.3	78.6	– 0.9	+14.0
Food	79.3	79.6	– 2.2	+15.3
Industrials				
All	77.0	77.2	+ 1.0	+12.2
Nfa†	80.0	80.2	+ 0.7	+18.1
Metals	74.5	74.6	+ 1.4	+ 7.4
Sterling index				
All items	78.6	78.4	+ 3.2	+ 2.4
Euro index				
All items	95.8	94.8	– 1.2	– 9.1
Yen index				
All items	97.8	98.5	– 2.6	+ 1.6
Gold				
$ per oz	352.45	353.50	– 6.7	+18.5
West Texas Intermediate				
$ per barrel	36.04	36.89	+10.1	+58.5

* Provisional. † Non-food agriculturals.

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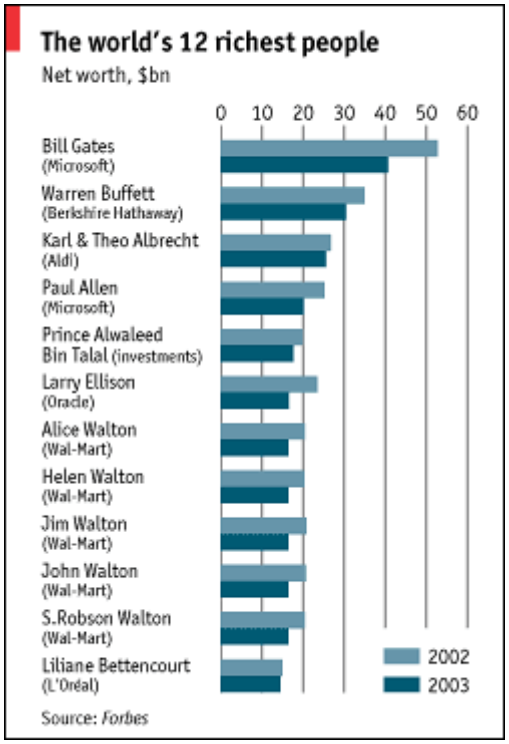
The world's 12 richest people

Mar 6th 2003
From The Economist print edition



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Overview

Mar 6th 2003
From The Economist print edition

Turkey's financial prospects look gloomier after its parliament voted on March 1st not to allow American troops to use Turkey as a base from which to attack Iraq. This puts $30 billion of promised American financial assistance in jeopardy. The Ankara stockmarket fell by 4.2% over the week.

Venezuela's consumer prices jumped by 5.5% in February, the highest monthly rise for almost seven years. Prices rose by 38.7% over the 12 months, up from 13.7% a year earlier. Inflation in Venezuela has been fuelled by the introduction of new foreign-exchange controls, which have caused many imported goods to become scarcer.

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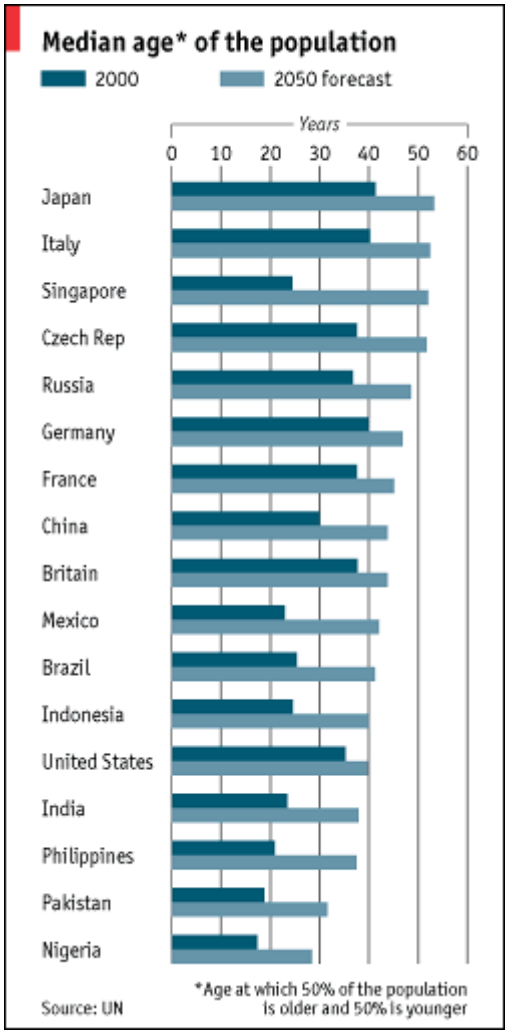
Median age* of the population

Mar 6th 2003
From The Economist print edition

Over the past 50 years, the median age of the world's population has increased by a mere three years, from 23.6 in 1950 to 26.4 in 2000. (The median marks the point where half the population is older than that age and half is younger). But over the next 50 years, the median age will jump to 37, according to the latest projections made by the United Nations. By 2050, 17 developed countries are expected to have a median age of 50 or more.



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Economy

Mar 6th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.1	Q4	+14.8	Jan	+ 0.4	Jan	+26.5	Jan	+17.4	2001	269.9	Oct
Hong Kong	+ 3.3	Q3	– 7.2	Q3	– 1.6	Jan	– 6.9	Jan	+16.5	Q3	115.6	Jan
India	+ 5.8	Q3	+ 5.0	Dec	+ 3.2	Dec	– 7.3	Dec	+ 4.5	Q3	69.9	Jan
Indonesia	+ 3.8	Q4	+ 7.1	Dec‡	+ 7.3	Feb	+25.4	Dec	+ 7.5	Q3	31.1	Jan
Malaysia	+ 5.6	Q4	+ 8.0	Dec	+ 1.7	Jan	+13.9	Jan	+ 6.6	Q3	33.5	Jan
Philippines	+ 5.8	Q4	– 5.0	Dec	+ 3.1	Feb	+ 1.6	Dec	+ 6.1	Sep	13.2	Jan
Singapore	+ 2.6	Q4	+13.5	Jan	+ 0.9	Jan	+ 9.8	Jan	+18.7	Q4	84.0	Jan
South Korea	+ 5.8	Q3	+ 3.6	Jan	+ 3.9	Feb	+ 9.3	Feb	+ 6.5	Nov	122.8	Jan
Taiwan	+ 4.2	Q4	+ 8.5	Jan	– 1.5	Feb	+16.3	Jan	+25.8	Q4	166.3	Feb
Thailand	+ 6.0	Q3	+13.0	Jan	+ 1.9	Feb	+ 4.6	Jan	+ 8.0	Jan	38.9	Jan
Argentina	–10.1	Q3	+13.1	Jan	+39.6	Jan	+15.9	Jan	+ 7.0	Q3	9.5	Jan
Brazil	+ 3.4	Q4	+ 5.5	Dec	+14.5	Jan	+14.1	Jan	– 6.3	Jan	37.8	Dec
Chile	+ 1.8	Q3	+ 2.8	Jan	+ 3.0	Jan	+ 2.5	Jan	– 0.6	Q4	16.4	Jan
Colombia	+ 2.0	Q4	+ 0.6	Nov	+ 7.2	Feb	nil	Nov	– 1.5	Q3	10.9	Jan
Mexico	+ 1.9	Q4	+ 1.7	Dec	+ 5.2	Jan	– 7.6	Jan	–14.5	Q4	50.6	Dec
Peru	+ 6.3	Dec	+11.7	Dec	+ 2.8	Feb	+ 0.3	Dec	– 1.0	Q3	9.3	Jan
Venezuela	–16.7	Q4	–10.5	Oct	+38.7	Feb	+13.9	Q4	+ 7.6	Q4	9.1	Nov
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.0	Dec	– 7.8	Nov	+ 0.1	Q3	13.0	Oct
Israel	+ 1.3	Q4	+ 1.3	Dec	+ 5.6	Jan	– 6.6	Jan	– 1.9	Q3	23.4	Feb
South Africa	+ 3.0	Q4	+ 1.5	Dec	+13.7	Jan	+ 3.9	Jan	nil	Q3	5.6	Jan
Turkey	+ 7.9	Q3	+13.5	Dec	+27.0	Feb	–15.7	Dec	+ 0.1	Nov	29.2	Jan
Czech Republic	+ 1.5	Q3	+ 6.6	Dec	– 0.4	Jan	– 2.3	Jan	– 4.2	Q3	24.3	Jan
Hungary	+ 3.7	Q4	+ 6.9	Dec	+ 4.7	Jan	– 3.0	Dec	– 2.7	Dec	15.3	Jan
Poland	+ 1.6	Q3	+ 4.2	Jan	+ 0.4	Jan	–10.3	Jan	– 6.5	Jan	29.3	Jan
Russia	+ 4.3	Q3	+ 4.9	Jan	+14.3	Jan	+46.2	Dec	+30.3	Q3	45.5	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	– 0.5	Jun	+ 3.4	Jan	– 1.4	Feb	+ 2.7	2002†	8.1	Dec
Saudi Arabia	+ 1.2	2001	na		– 0.9	Oct	+39.2	2001	+ 9.4	2001	20.6	Dec

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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Financial markets

Mar 6th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Mar 5th		Dec 31st 2002	
	Mar 5th	year ago	Mar 5th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.2	na	1,586.2	+0.3	+ 11.8	+ 11.8
Hong Kong	7.80	7.80	12.5	1.42	9,109.2	−0.1	− 2.3	− 2.3
India	47.7	48.7	76.3	5.80	3,226.1	−1.1	− 4.5	− 3.9
Indonesia	8,845	9,955	14,158	12.83	391.2	−1.6	− 7.9	− 6.9
Malaysia	3.80	3.80	6.08	3.10	643.1	−1.2	− 0.5	− 0.5
Philippines	54.8	51.1	87.7	8.00	1,009.7	+0.9	− 0.9	− 3.4
Singapore	1.73	1.82	2.77	0.69	1,265.5	−1.7	− 5.6	− 5.5
South Korea	1,199	1,311	1,919	4.53	560.3	−5.1	− 10.7	− 11.7
Taiwan	34.6	35.0	55.3	1.45	4,418.1	−0.9	− 0.8	− 0.2
Thailand	42.5	43.5	68.0	1.78	359.9	+1.1	+ 1.0	+ 2.4
Argentina	3.17	2.07	5.07	6.20	595.2	+1.6	+ 13.4	+ 20.5
Brazil	3.58	2.35	5.73	26.25	10,318.5	+3.2	− 8.4	− 9.5
Chile	756	667	1,210	2.52	5,070.8	+1.3	+ 1.0	− 3.8
Colombia	2,961	2,288	4,739	7.82	1,617.7	+1.1	+ 0.6	− 2.6
Mexico	11.20	9.07	17.9	9.60	5,914.4	+0.8	− 3.5	− 9.8
Peru	3.47	3.46	5.56	3.77	1,542.3	+0.9	+ 10.8	+ 12.1
Venezuela	1,598	981	2,558	31.09	8,155.7	+0.1	+ 1.8	− 11.7
Egypt	5.60	4.64	8.96	7.50	6,030.1	−0.5	+ 12.3	− 7.2
Israel	4.86	4.72	7.78	6.03	324.7	+3.5	− 2.3	− 4.5
South Africa	7.9	11.0	12.6	13.60	8,190.8	−1.0	− 11.7	− 3.7
Turkey	1,604,500	1,372,500	2,568,323	42.00	10,815.5	−4.2	+ 4.3	+ 7.9
Czech Republic	29.1	36.0	46.5	2.38	464.0	−3.1	+ 0.7	+ 4.2
Hungary	224	279	359	6.40	7,093.6	−2.3	− 9.0	− 8.7
Poland	3.91	4.15	6.26	6.26	13,502.7	−1.2	− 6.0	− 7.9
Russia	31.6	31.1	50.6	18.00	392.8	+3.7	+ 8.1	+ 9.4
EMF (MSCI)*	1.00	1.00	1.60	na	278.2	−1.2	na	− 4.7
EMBI+†	1.00	1.00	1.60	na	242.5	+1.1	na	+ 6.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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